

Tax Treatment of Charitable Contributions in Canada: Theory, Practice, and Reform

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Tax Treatment of Charitable Contributions in Canada: Theory, Practice, and Reform

Abstract

Tax recognition for charitable contributions in Canada takes the form of a deduction where the contribution is made by a corporation or for the purpose of gaining or producing income from a business, a nonrefundable credit where individuals make qualifying gifts to eligible recipients, and a reduction or exemption from capital gains tax on gifts to eligible recipients of qualifying cultural property, publicly traded securities, or ecologically sensitive land. This article reviews different rationales for the tax recognition of charitable contributions, concluding that the most persuasive rationale is to indirectly subsidize the quasi-public goods and services that charities provide and the social and cultural pluralism that they advance. The article goes on to evaluate current rules by reference to these rationales for tax recognition and makes specific proposals for reforming Canadian tax rules in light of this evaluation.

Keywords

Taxation--Law and legislation; Charitable contributions

TAX TREATMENT OF CHARITABLE CONTRIBUTIONS IN CANADA: THEORY, PRACTICE, AND REFORM[©]

BY DAVID G. DUFF*

Tax recognition for charitable contributions in Canada takes the form of a deduction where the contribution is made by a corporation or for the purpose of gaining or producing income from a business, a non-refundable credit where individuals make qualifying gifts to eligible recipients, and a reduction or exemption from capital gains tax on gifts to eligible recipients of qualifying cultural property, publicly traded securities, or ecologically sensitive land. This article reviews different rationales for the tax recognition of charitable contributions, concluding that the most persuasive rationale is to indirectly subsidize the quasi-public goods and services that charities provide and the social and cultural pluralism that they advance. The article goes on to evaluate current rules by reference to these rationales for tax recognition and makes specific proposals for reforming Canadian tax rules in light of this evaluation.

La reconnaissance fiscale des contributions caritatives au Canada revêt la forme soit d'une déduction lorsque la contribution est faite par une Société ou bien en vue de gagner ou de produire des revenus dans une entreprise, soit d'un crédit non-remboursable lorsque des particuliers font des dons permis à des bénéficiaires admissibles, soit d'une réduction ou d'une exemption des impôts relatifs aux gains en capital sur les dons en faveur des bénéficiaires admissibles d'une propriété culturelle admise, de valeurs mobilières cotées en Bourse, ou de terrains critiques pour l'écologie. Cet article analyse les divers motifs du traitement fiscal des contributions caritatives, pour conclure que le motif le plus persuasif est celui de la subvention indirecte des biens et services quasi-publics que fournissent les organismes caritatifs et le pluralisme socio-culturel que favorisent ces derniers. L'article se poursuit par l'évaluation des règles actuelles en référence à ces motifs de reconnaissance fiscale, et formule des propositions précises visant à réformer les règles fiscales canadiennes à la lumière de cette évaluation.

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I.	INTRODUCTION	

The recognition of charitable contributions under the income tax scheme is generally justified on one of three grounds: to obtain an accurate measure of the donor's income that is subject to tax, to reward the donor's generosity, or to provide an indirect subsidy to eligible recipients by encouraging charitable donations. While the first of these rationales suggests that tax recognition should take the form of a deduction in computing net or taxable income, the implications of the other rationales are less obvious.

In Canada, tax recognition for contributions to charitable organizations takes four separate forms. First, where a charitable contribution is made for the purpose of gaining or producing income from a business, Canadian courts have held that the amount of the donation is deductible under general rules governing the computation of the donor's net income from the business.¹ Second, where a corporation makes a qualifying gift to an eligible recipient, the corporation may deduct the fair market value of the gift in computing its taxable income either in the year of the gift or in any one of the five subsequent taxation years, subject to a limit expressed as a percentage of the corporation's income for the year.²

¹ See *Olympia Floor & Wall Tile (Quebec) Ltd. v. MNR*, [1970] Ex. C.R. 274; *Impenco Ltd. v. M.N.R.* (1988), 88 D.T.C. 1242 (T.C.C.).

² *Income Tax Act*, R.S.C. 1985 (5th Supp.), c.1, s. 110.1 [Act]. As a general rule, the annual ceiling on deductible gifts is three-quarters of the corporation's income for the year. This limit is increased where the corporation is subject to capital gains or recaptured depreciation on donations of capital property and does not apply to gifts of cultural property, ecological gifts, or gifts to the Crown.

Third, where an individual makes a qualifying gift to an eligible recipient, the individual may claim a non-refundable credit against basic income tax otherwise payable, the amount of which is computed as a percentage of the aggregate fair market value of all such gifts made during the year or in any of the preceding five years, also subject to a limit expressed as a percentage of the individual's income for the year.³ Finally, where property donated to an eligible recipient is qualifying cultural property, publicly traded securities, or ecologically sensitive land, special rules reduce or eliminate the capital gains tax that would otherwise be payable if this property had appreciated in value prior to the making of the gift.⁴ As a result, the Canadian income tax recognizes contributions to charitable organizations through a deduction in some circumstances, a non-refundable credit in others, and a full or partial exemption from capital gains tax otherwise payable on gifts of certain kinds of appreciated property.

This article discusses the tax treatment of charitable contributions in Canada, evaluating each of these approaches by reference to what I contend to be the most persuasive rationales for tax recognition and recommending specific reforms to the current statutory scheme. Part II considers different rationales for, and approaches to, the tax recognition of charitable contributions, concluding that such recognition may be justified both where donations are made for the purpose of gaining or producing income and as a way of subsidizing the quasi-public goods and services provided by charitable organizations and the social and cultural pluralism advanced by these organizations. Part III picks up on the second of these rationales, reviewing current statutory rules and judicial decisions governing eligible recipients, qualifying gifts, and different methods of tax recognition. Part IV recommends specific reforms to the current statutory scheme in light of the theoretical approach advanced in Part II. Part V provides a brief conclusion.

³ The federal credit, on which provincial credits are based, appears in section 118.1 of the *Act*. As with the deduction for corporate donations, the limit on the aggregate fair market value of gifts that may be claimed in a taxation year is generally three-quarters of the individual's income for the year, but it is increased where the individual is subject to capital gains or recaptured depreciation on donations of capital property and it does not apply to gifts of cultural property, ecological gifts, or gifts to the Crown.

⁴ *Act*, *supra* note 2, s. 39(1)(a)(i.1), which exempts any capital gain on gifts of property that the Canadian Cultural Property Export Review Board determines meets the criteria set out in the *Cultural Property Export and Import Act*, R.S.C. 1985, c. C-51, ss. 29(3)(b) and (c), provided that the donation is made to an institution or public authority designated under s. 32(2) of that act; s. 38(a)(1), which reduces the inclusion rate on gifts of publicly traded securities from one-half to one-quarter; and s. 38(a)(2), which reduces the inclusion rate on gifts of ecologically sensitive land from one-half to one-quarter.

II. THEORY: RATIONALES FOR TAX RECOGNITION OF CHARITABLE CONTRIBUTIONS

Tax recognition of charitable contributions is generally favoured on one of three grounds: to obtain an accurate measure of the donor's taxable income, to reward the donor's generosity, or to provide an indirect subsidy to charitable organizations by encouraging donations. The following discussion evaluates each of these rationales and their implications for the manner in which charitable contributions should be recognized for tax purposes.⁵ Rejecting the view that tax recognition is necessary to measure taxable income or to reward generosity, I argue that such recognition is best justified as an indirect subsidy for the quasi-public goods and services provided by the charitable sector.

A. *Measuring Taxable Income*

The accurate measurement of taxable income is a question of horizontal equity, a basic principle of tax fairness according to which taxpayers who are similarly situated should pay similar amounts in tax. While the concept of horizontal equity affirms the principle of formal equality, the determination of whether two or more taxpayers are similarly situated for the purpose of an income tax depends on a substantive conception of the ideal tax base. Since the definition of this base involves inclusions and deductions, the characterization of a measurement of taxable income as accurate turns on the specification of appropriate inclusions and deductions.

As a general rule, those favouring the taxation of income, as opposed to personal consumption, have preferred an expansive concept of appropriate inclusions in order to ensure that the income tax applies to a broad measure of each taxpayer's ability to pay.⁶ According to Robert Haig, for example, the definition of taxable income should include "the

⁵ Parts of this discussion are based on David G. Duff, "Charitable Contributions and the Personal Income Tax: Evaluating the Canadian Credit" in Jim Phillips, Bruce Chapman & David Stevens, eds., *Between State and Market: Essays on Charities Law and Policy in Canada* (Montreal: McGill-Queen's University Press, 2001) 407 at 426-36 [Duff, "Charitable Contributions"].

⁶ See e.g. Robert Murray Haig, "The Concept of Income – Economic and Legal Aspects" in Robert Murray Haig, ed., *The Federal Income Tax* (New York: Columbia University Press, 1921) 27; Henry C. Simons, *Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy* (Chicago: University of Chicago Press, 1938); R.A. Musgrave, "In Defense of an Income Concept" (1967) 81 Harv. L. Rev. 44; and Victor Thuronyi, "The Concept of Income" (1990) 46 Tax L. Rev. 45. For a more critical view see Boris I. Bittker, "A 'Comprehensive Tax Base' as a Goal of Income Tax Reform" (1967) 80 Harv. L. Rev. 925.

money value of the net accretion to one's economic power between two points of time."⁷ Similarly, suggesting that income "connotes, broadly, the exercise of control over the use of society's scarce resources," Henry Simons proposed that taxable income should include "(1) the market value of rights exercised in consumption and (2) the change in the value of the store of property rights between the beginning and end of the period in question."⁸

Theoretical approaches differ with respect to appropriate deductions.⁹ Although most conceptions of horizontal equity accept the legitimacy of deductions for reasonable expenses incurred by taxpayers for the purpose of producing taxable income,¹⁰ opinion is divided on the extent to which personal expenses should be deductible in computing taxable income. While many tax theorists favour the deduction of non-discretionary personal expenses as necessary adjustments to measure each taxpayer's ability to pay,¹¹ others reject the deduction of all personal expenses on the grounds that they are discretionary or otherwise irrelevant to the appropriate definition of taxable income¹² or inferior to other policy instruments as a way of subsidizing these expenses.¹³ Adopting an altogether different approach, William Andrews has relied on Simons' definition of personal income as the sum of personal consumption and

⁷ Haig, *ibid.* at 59 [emphasis omitted].

⁸ Simons, *supra* note 6 at 50.

⁹ For an excellent discussion of different approaches, see Tim Edgar, "The Concept of Taxable Consumption and the Deductibility of Expenses Under an Ideal Personal Income Tax Base" in Richard Krever, ed., *Tax Conversations: A Guide to the Key Issues in the Tax Reform Debate* (London: Kluwer Law International, 1997) 293.

¹⁰ See e.g. Richard Goode, *The Individual Income Tax*, rev. ed. (Washington: The Brookings Institution, 1976) at 75; Wayne R. Thirsk, "Giving Credit Where Credit is Due: The Choice Between Credits and Deductions Under the Individual Income Tax in Canada" (1980) 28 Can. Tax J. 32 at 33.

¹¹ See e.g. Pierre Cloutier & Bernard Fortin, "Converting Exemptions and Deductions into Credits: An Economic Assessment" in Jack Mintz & John Whalley, eds., *The Economic Impacts of Tax Reform* (Toronto: Canadian Tax Foundation, 1989) 45 at 54-62; Robin W. Boadway & Harry M. Kitchen, *Canadian Tax Policy*, 3d ed. (Toronto: Canadian Tax Foundation, 1999) at 131.

¹² See e.g. Neil Brooks, "Comments on the Paper by Robin W. Boadway and Harry M. Kitchen" (1999) 47 Can. Tax J. 608 ("One of the most fundamental principles underlying a fair tax system is that business expenses are deductible and personal expenses are not" at 621.) See also Neil Brooks, "The Irrelevance of Conjugal Relationships in Assessing Tax Liability" in John G. Head & Richard Krever, *Tax Units and the Rate Scale* (Melbourne: Australian Tax Research Foundation, 1996) 35.

¹³ See e.g. National Council on Welfare, *The Hidden Welfare System* (Ottawa: National Council on Welfare, 1976) (regarding these deductions as "upside-down" subsidies worth more to high-income taxpayers than low-income taxpayers, at 16-19). Implicit in this critique, though generally not acknowledged, is an assumption about the appropriate tax base, by reference to which deductions for personal expenses are characterized as subsidies.

savings to advance an alternative conception of taxable income, according to which deductions would be allowed for all expenditures not amounting to personal consumption or savings.¹⁴

Elsewhere, I have questioned Andrews' concept of taxable income¹⁵ and favoured a concept of horizontal equity that allows deductions for non-discretionary expenses.¹⁶ Although Andrews' approach might be appropriate for a tax on personal consumption,¹⁷ it contradicts what I regard as the key purpose of an income tax: to impose a social claim on a share of each taxpayer's annual gains from participation in the market economy.¹⁸ While the latter approach is consistent with the denial of any deduction for personal expenses, it is my view that attention to differences in taxpayers' personal circumstances favours deductions for non-discretionary expenses such as the costs of basic subsistence, family obligations, or necessary medical care.¹⁹

From this perspective on the appropriate tax base, one can evaluate alternative arguments that tax recognition for charitable contributions is necessary to obtain an accurate measure of the donor's taxable income. Although this rationale implies that such recognition should take the form of a deduction, the concept of taxable income advanced in the previous paragraph rejects Andrews' view that charitable gifts that do not enter into the donor's personal consumption ought to be deductible in computing the donor's income.²⁰ On the contrary, to the extent that the donor is legally

¹⁴ William D. Andrews, "Personal Deductions in an Ideal Income Tax" (1972) 86 Harv. L. Rev. 309.

¹⁵ Duff, "Charitable Contributions", *supra* note 5 at 427-28.

¹⁶ See David G. Duff, "Disability and the Income Tax" (2000) 45 McGill L.J. 797 [Duff, "Disability"]; and David G. Duff, "Tax Policy and the Family: A North American Comparison" in *Proceedings of the Fifteenth Annual Conference of the Foundation for Fiscal Studies* (Dublin: Foundation for Fiscal Studies, 2000) 36 [Duff, "Tax Policy and the Family"].

¹⁷ See e.g. William D. Andrews, "A Consumption-Type or Cash Flow Personal Income Tax" (1974) 87 Harv. L. Rev. 1113.

¹⁸ For an excellent statement of this concept, see Alvin Warren, "Would a Consumption Tax be Fairer than an Income Tax?" (1980) 89 Yale L.J. 1081 (arguing, among other things, that "a producer does not have a controlling moral claim over the product of his capital and labor, given the role of fortuity in income distribution and the dependence of producers on consumers and other producers to create value in our society—factors that create a general moral claim on all private product on behalf of the entire society" at 1090-93). See also Charles R. O'Kelley, Jr., "Rawls, Justice, and the Income Tax" (1981) 16 Ga. L. Rev. 1; and David G. Duff, "Taxing Inherited Wealth: A Philosophical Argument" (1993) 6 Can. J.L. & Jur. 3 (discussing competing claims of individual and social desert within a liberal-egalitarian conception of distributive justice at 54-56).

¹⁹ See Duff, "Disability," *supra* note 16; and Duff, "Tax Policy and the Family," *supra* note 16.

²⁰ *Supra* note 14 at 317-31.

entitled to the income from which the charitable contribution is made, the concept of income as the taxpayer's share of social output suggests that the amount of the donation should be included in computing the donor's income.²¹ Similarly, while the concept of income proposed in the previous paragraph would permit a deduction for non-discretionary personal expenses, it is difficult to regard charitable contributions as non-discretionary in the same way as the costs of basic subsistence, family obligations, or necessary medical care. Instead, notwithstanding Boris Bittker's argument that "charitable contributions represent a claim of such a high priority" that they should be excluded "in determining the amount of income at the voluntary disposal of the taxpayer in question,"²² charitable gifts are best characterized as a discretionary form of personal expenditure not unlike other consumption expenses which are not deductible in computing a taxpayer's income.²³ In contrast, where a taxpayer donates cash or property to a charitable organization for the purpose of earning income, this donation is properly deductible in computing the taxpayer's income as an ordinary business expense.

B. Rewarding Generosity

As an alternative to the accurate measurement of income rationale, tax recognition for charitable contributions is also favoured on the basis

²¹ For similar responses to Andrew's view, see Stanley S. Surrey, *Pathways to Tax Reform: The Concept of Tax Expenditures* (Cambridge, Mass.: Harvard University Press, 1973) at 20-21; Rick Krever, "Tax Deductions for Charitable Donations: A Tax Expenditure Analysis" in Richard Krever & Gretchen Kewley, eds., *Charities and Philanthropic Institutions: Reforming the Tax Subsidy and Regulatory Regimes* (Melbourne: Australian Tax Research Foundation, 1991) 1 at 5-8.

²² Boris I. Bittker, "The Propriety and Vitality of a Federal Income Tax Deduction for Private Philanthropy" in *Tax Impacts on Philanthropy. Symposium conducted by the Tax Institute of America, December 2-3, 1971* (Princeton: Tax Institute of America, 1972) 145 at 165 [Bittker, "Propriety"]. For a similar argument see also Mark P. Gergen, "The Case for a Charitable Contribution Deduction" (1988) 74 Va. L. Rev. 1393 at 1426-33.

²³ See e.g. Gwyneth McGregor, "Charitable Contributions" (1961) 9 Can. Tax J. 441 ("Charitable contributions ... are not a vital necessity of life and are voluntary" at 442); Edward H. Rabin, "Charitable Trusts and Charitable Deductions" (1966) 41 N.Y.U.L. Rev. 912 ("the charitable deduction exists almost solely to encourage charitable giving, not to relieve hardship caused by 'involuntary' expenses" at 915); James A. Rendall, "Taxation of Contributors to Charitable Organizations Under the Income Tax Act" in *Report of the Proceedings of the Twenty-Fifth Tax Conference. November 19-21, 1973* (Toronto: Canadian Tax Foundation, 1974) 152 (characterizing charitable contributions as "consumption" at 153); Boadway & Kitchen, *supra* note 11 (contrasting medical expenses, which are almost always involuntary, with charitable donations, which "are not a vital necessity of life and tend to be made on a voluntary basis" at 133); and Ellen P. Aprill, "Churches, Politics, and the Charitable Contribution Deduction" (2001) 42 B.C.L. Rev. 843 ("charitable contributions are made voluntarily, as a discretionary use of income" at 870).

that it rewards generosity as a form of virtuous behaviour. For example, Bittker suggests, in addition to other arguments for a charitable deduction, that "something can be said for rewarding activities that in a certain sense are selfless, even if the reward serves no incentive function."²⁴ Similarly, Richard Goode has referred to the U.S. deduction for charitable contributions as a "reward" for charitable giving.²⁵

As a reward for the donor's generosity, tax recognition for charitable contributions should logically take the form of a tax benefit, the value of which is geared in some way to a measure of the donor's relative sacrifice.²⁶ Given statistics indicating that low-income donors tend to give a larger percentage of their incomes to charities than high-income donors,²⁷ this rationale for tax recognition suggests that a deduction, the value of which increases as the donor's income increases, has the reward structure backwards. Instead, assuming a diminishing marginal utility of income, one might favour a benefit that decreases as the donor's income increases. Neil Brooks, for example, has suggested that a tax credit for charitable contributions "could be set at 30 per cent for those with incomes over \$35,000; 40 per cent for those with incomes from \$25,000 to \$35,000, and so on, down to those with incomes under \$10,000, where the credit might be set at 100 per cent."²⁸ To the extent that a donor's relative sacrifice

²⁴ Bittker, "Propriety", *supra* note 22 at 166.

²⁵ *Supra* note 10 at 165.

²⁶ See e.g. Paul R. McDaniel, "Federal Matching Grants for Charitable Deductions: A Substitute for the Income Tax Deduction" (1972) 27 Tax L. Rev. 377 ("if there is to be a reward for charitable giving, the incidence and amount of the reward should bear some rational relationship to the act of charitable giving. The reward should be the same for persons who make a similar sacrifice, however measured" at 394).

²⁷ See e.g. Richard M. Bird & Meyer W. Bucovetsky, *Canadian Tax Reform and Private Philanthropy*, Tax Paper No. 58 (Toronto: Canadian Tax Foundation, 1976) (reporting for the 1972 taxation year that for taxpayers claiming charitable contributions, the percentage of average income among different income groups was 7.8 per cent for donors with incomes less than \$5,000, 4.1 per cent for donors with incomes of \$5,000 to \$10,000, 2.9 per cent for donors with incomes of \$10,000 to \$20,000, 2.4 per cent for donors with incomes of \$20,000 to \$50,000, 2.4 per cent for donors with incomes of \$50,000 to \$100,000, and 3.6 per cent for donors with incomes exceeding \$100,000 at 18 (Table 18)). More recent figures from the 1990 taxation year, demonstrate a similar U-shaped ratio of charitable donations to income level of donors, falling from 4.1 per cent for donors with taxable incomes less than \$10,000 to 2.1 per cent for donors with taxable incomes of \$10,000 to \$30,000, 1.4 per cent for donors with taxable incomes of \$30,000 to \$50,000, 1.3 per cent for donors with taxable incomes of \$50,000 to \$100,000, 1.7 per cent for donors with taxable incomes of \$100,000 to \$250,000, and 1.9 per cent for donors with taxable incomes exceeding \$250,000 (calculated from figures in Revenue Canada, *Taxation Statistics on Individuals: 1990 Tax Year* (Ottawa: Minister of Supply and Services, 1992)).

²⁸ Neil Brooks, *Financing the Voluntary Sector: Replacing the Charitable Deduction* (Toronto: Law and Economics Workshop Series, Faculty of Law, University of Toronto) at 24 [Brooks, *Financing the Voluntary Sector*].

depends on wealth as well as income, one might imagine a tax benefit that decreases as the donor's wealth and income increase.

Alternatively, the amount of the tax benefit might vary according to the percentage of the taxpayer's annual income, or the wealth contributed by the taxpayer to eligible recipients during the year.²⁹ On this basis, Paul McDaniel has proposed a matching grant for charitable donations that would rise from 5 per cent of aggregate donations for donors contributing less than 2 per cent of their incomes to charities to 50 per cent of aggregate donations for donors contributing more than 10 per cent of their incomes.³⁰ For similar reasons, others have advocated a floor on any tax recognition for charitable contributions, set at a fixed percentage of each taxpayer's income for the year.³¹ In 1969, for example, the U.S. Treasury Department proposed that the charitable deduction in the U.S. *Internal Revenue Code* be available only for contributions exceeding 3 per cent of the donor's income.³² Likewise, the Canadian Royal Commission on Taxation (Carter Commission) considered, but rejected, a floor set at 1 per cent of the donor's income.³³ Besides targeting the reward at the most generous contributors, such a floor would also reduce administrative costs associated with tax assistance for charitable giving.³⁴

Although a reward rationale for the tax recognition of charitable contributions suggests a number of possible methods for this recognition, the rationale itself is deeply problematic. While generosity is undoubtedly worthy of praise, it is not clear that it merits monetary rewards. On the contrary, as critics from radically different philosophical perspectives have pointed out, to reward generosity through monetary means contradicts the spirit underlying the virtue of generosity, "corrupt[ing] the essential dignity

²⁹ See e.g. McDaniel, *supra* note 26 (arguing that the reward rationale "appears to call for a system which increases the reward as the individual sacrifices a greater proportion of his income to charity" at 394).

³⁰ *Ibid.* at 397.

³¹ See e.g. Bittker, "Propriety", *supra* note 22 (suggesting that the floor should exclude the least generous 10 or 20 per cent of donors, at 169); Goode, *supra* note 10 (explaining that such a measure would "focus the reward or incentive more sharply by withdrawing the deduction from persons whose contributions are small relative to income while continuing it for heavier contributions" at 165).

³² See the discussion of this proposal in McDaniel, *supra* note 26 at 387-88.

³³ Canada, *Report of the Royal Commission on Taxation*, vol. 3 (Ottawa: Queen's Printer, 1966) at 224.

³⁴ See e.g. Rendall, *supra* note 23 at 159; Goode, *supra* note 10 at 165. See also the discussion in Aprill, *supra* note 23 (proposing the idea of an income-related floor on deductible charitable contributions as a solution to administrative concerns with the extension of the deduction to non-itemizers in the United States, at 859-62).

and altruism of a simple gift”³⁵ and “accentuat[ing] the purely selfish goal of reducing one’s own taxes.”³⁶ Moreover, as John Colombo suggests, “[t]he work of social scientists may even indicate that providing a material reward for giving may actually decrease the giving rate where part of what individuals want from their donation is the ‘warm glow’ and increased self-esteem from behaving altruistically.”³⁷ Therefore, as a rationale for the tax recognition of charitable contributions, the reward rationale is no more persuasive than the rationale that a deduction is necessary to ensure an accurate measure of taxable income.

C. *Subsidizing Charitable Activities*

A third rationale for the tax recognition of charitable contributions is to provide an indirect subsidy to charitable activities by encouraging charitable gifts. To the extent that charitable giving is what economists describe as a “normal good,” the demand for which increases as the price decreases, tax incentives will increase the quantity of charitable gifts by decreasing their after-tax cost to the donor.³⁸ By increasing aggregate contributions to charitable organizations, therefore, these incentives provide an indirect subsidy to the charitable sector.

In order to evaluate the merits of this argument, it is necessary to examine both the initial justification for subsidizing the charitable sector and the reasons why indirect subsidies delivered in the form of tax incentives might be preferred to direct subsidies in the form of sustaining or matching grants. Finally, on this basis it is useful to consider the

³⁵ E. Blake Bromley, “Charity, Philanthropy and Stewardship: A Philosophical Perspective on Tax Reform” (1988) 7:2 *Philanthrop.* 4 at 12.

³⁶ Neil Brooks, “The Tax Credit and Charitable Contributions: Giving Credit where None is Due” in Phillips, Chapman & Stevens, *supra* note 5, 457 at 464 [Brooks, “The Tax Credit and Charitable Contributions”]. See also Gergen, *supra* note 22 (asking why, if a society values altruism, it would want to “sully” this virtue with “a pecuniary reward” at 1395).

³⁷ John D. Colombo, “The Marketing of Philanthropy and the Charitable Contributions Deduction: Integrating Theories for the Deduction and Tax Exemption” (2001) *Wake Forest L. Rev.* 657 at 677.

³⁸ As economic analysis suggests, this response is a product of the “income effect,” which increases the donor’s after-tax income from which gifts may be made and the “substitution effect” which reduces the after-tax cost of these gifts compared to other expenditure items. See Michael K. Taussig, “Economic Aspects of the Personal Income Tax Treatment of Charitable Contributions” (1967) 20 *Nat’l Tax J.* 1 (explaining that “[o]nly the price or substitution effect of deductibility can be properly regarded as the result of using the deduction as a policy variable, since the income effect of deductibility is incidental and could be achieved equally well by a cut in tax rates, an increase in personal exemptions, and by similar alternative devices” at 3).

implications of this rationale for the manner in which a tax incentive for charitable contributions might reasonably be designed.

1. Public Benefits and the Charitable Sector

Among economists, the charitable sector is generally regarded as a provider of quasi-public goods and services, the essential characteristics of which are relative non-rivalness, meaning that enjoyment by one person does not preclude enjoyment by another, and relative non-excludability, meaning that it is difficult or impossible to exclude individuals from enjoying the benefit even if they refuse to pay for it.³⁹ Economic theory suggests that private markets will oversupply non-rival but excludable goods and services and under-supply non-excludable goods or services. In either case, the resolution of these "market imperfections" is one of the main economic justifications for the existence of a public sector that provides these public goods and services directly, distributing their costs among individual beneficiaries through taxes and other levies.⁴⁰

In addition to the public sector, the charitable sector represents another response to the existence of market imperfections, providing various goods and services such as education, culture, and religion, the benefits of which are relatively non-rival and non-excludable. Indeed, since charitable organizations enable individuals to select a range of public goods and services corresponding to their own values and preferences, this sector may in some contexts have distinct advantages over the broader public sector in providing a mix of such goods and services that are more compatible with the demands of a diverse society.⁴¹ Furthermore, to the

³⁹ See e.g. Kimberley Scharf, Ben Cherniavsky & Roy Hogg, *Tax Incentives for Charities in Canada*, Working Paper No. CPRN 03 (Ottawa: Canadian Policy Research Networks, 1997) at 4-5.

⁴⁰ In addition to this economic justification for the existence of a public sector, public finance scholars typically identify as other "fiscal functions" the "distribution function" to moderate inequalities in the distribution of market outcomes and the "stabilization function" to moderate macroeconomic fluctuations associated with the business cycle. See e.g. Richard A. Musgrave, Peggy B. Musgrave & Richard M. Bird, *Public Finance in Theory and Practice*, 1st Canadian ed. (Toronto: McGraw-Hill Ryerson, 1987).

⁴¹ See e.g. Lester M. Salamon, "Partners in Public Service: The Scope and Theory of Government-Nonprofit Relations" in Walter Powell, ed., *The Nonprofit Sector: A Research Handbook* (New Haven, Conn.: Yale University Press, 1987) 99; Krever, *supra* note 21 at 8-13. The normative value underlying this argument is that of economic efficiency, according to which scarce resources should be allocated to the uses where they are valued most, absent other considerations such as those of distributive justice. As a general rule, this approach does not question the values and preferences that citizens may have with respect to the type and quantity of public goods and services, but takes them as given and attempts to maximize their satisfaction. In this respect, the economic approach incorporates an appreciation of individual sovereignty characteristic of various forms of liberal theory. Respect for diversity and social

extent that the charitable sector is more innovative and service-oriented than the traditional public sector, it may provide a more efficient vehicle for the delivery of certain public goods and services.⁴² Finally, by relieving the public sector from the sole responsibility of providing public goods and services, the charitable sector lessens the fiscal burdens of the public sector, making it better able to perform the important redistribution, allocation, and stabilization functions that only it can effectively fulfill.⁴³

While it would be wrong to idealize the role that charities can play in the delivery of public goods and services,⁴⁴ these arguments suggest that charitable organizations can play a valuable role in this area, in aid of which they should receive financial support from the broader public sector. Where charitable organizations provide alternative methods of delivering public goods and services to those employed by the traditional public sector, they should be supported by public funds. To the extent that charitable organizations provide quasi-public goods and services, economic theory also supports the subsidization of these activities in order to prevent their undersupply.⁴⁵

2. Tax Incentives versus Direct Subsidies

Assuming that public subsidies for the charitable sector are justified, it does not necessarily follow that these subsidies should be

pluralism are manifestations of this underlying attitude toward individual sovereignty. See e.g. John Stuart Mill, "On Liberty (1859)" in H.B. Acton, ed., *John Stuart Mill: Utilitarianism, Liberty, Representative Government*, (London: Everyman's Library, 1972).

⁴² See e.g. Scharf, Cherniavsky & Hogg, *supra* note 39 (suggesting that "voluntary organizations foster a do-it-yourself culture, which can improve accountability, encourage technological innovation, and promote efficiency in the use of resources, which may be more desirable if government provision is encumbered with a lot of bureaucracy" at 5). See also Richard Domingue, *The Charity "Industry" and its Tax Treatment* (Ottawa: Minister of Supply and Services, 1995) (arguing that "[a]t a time when attempts are being made to reinvent government, it should perhaps be recognized that social services could be provided much more efficiently by charitable organizations. It could be that communities and local agencies are in a better position to assess and meet these needs economically than government employees working in a capital city far removed from the people they serve" at 3).

⁴³ See e.g. McGregor, *supra* note 23 (noting that charitable contributions "relieve the government of some of its responsibilities, and make possible some activities, such as those of a cultural nature, which the government might not feel impelled, or be able, to afford to carry on" at 442).

⁴⁴ For a more critical assessment of the appropriate role of the charitable sector, see Neil Brooks, "The Role of the Voluntary Sector in a Modern Welfare State," in Phillips, Chapman & Stevens, *supra* note 5, 166. Common criticisms are that charities, unlike governments, tend to rely on non-professional staff and volunteers, have unstable funding sources and service capacities, and are decentralized, uncoordinated, and largely unaccountable to the public.

⁴⁵ See Harold M. Hochman & James D. Rodgers, "The Optimal Tax Treatment of Charitable Contributions" (1977) 30 *Nat'l Tax. J.* 1 at 2-3. See also Gergen, *supra* note 22 at 1396-1414.

delivered in the form of tax incentives directed at persons making donations to charitable organizations rather than direct subsidies to the organizations themselves. Critics of tax incentives for charitable contributions have raised two objections to these indirect subsidies as a way of providing financial support to the charitable sector. First, tax incentives are an inefficient way to subsidize charitable organizations, costing more in foregone revenues than they produce in increased contributions. Second, tax expenditures for charitable contributions lack the rationality, controllability, accountability, and transparency associated with direct government expenditures.⁴⁶ Notwithstanding these objections, however, it is my view that the social and cultural pluralism that sustains the charitable sector favours indirect subsidies in the form of tax incentives either instead of or in addition to direct grants.⁴⁷

a. Efficiency

The cost-effectiveness of a tax incentive for charitable contributions as opposed to direct government subsidies depends on the extent to which the aggregate amount of charitable gifts increases in response to a decrease in their after-tax cost as a result of the incentive—a relationship that economists describe as the “price elasticity of giving.”⁴⁸ Since reductions in the after-tax cost of gifts are financed by foregone tax revenues, the price elasticity of charitable giving reflects the cost-effectiveness of the tax incentive as a means of funding the charitable sector. While a high price elasticity indicates that an increase in the aggregate amount of charitable donations attributable to the tax incentive exceeds the cost of the tax in terms of foregone revenues, a low price elasticity indicates that the foregone tax revenues attributable to the tax incentive exceed the resulting increase in the amount of charitable donations.

⁴⁶ See e.g. Rabin, *supra* note 23 at 918-25; Brooks, “The Tax Credit for Charitable Contributions”, *supra* note 36 at 467-72.

⁴⁷ Indeed, studies indicate that direct government funding constitutes a much larger (and increasing) share of the revenues of charitable organizations in Canada than donations. See e.g. Kathleen M. Day & Rose Ann Devlin, *Canadian Nonprofit Sector*, Working Paper No. CPRN-2 (Ottawa: Canadian Policy Research Networks, 1997) (reporting that the percentage of charitable organization revenues derived from government funding increased from 42.8 per cent in 1989 to 60.2 per cent in 1994, while the percentage of revenues from donations decreased from 21.8 per cent in 1989 to 11.3 per cent in 1994, at 15-16).

⁴⁸ For a useful introduction to this concept, see Scharf, Cherniavsky & Hogg, *supra* note 39 at 8-9. Briefly, a low price elasticity of charitable giving indicates a slight increase in the aggregate giving in response to a decrease in the after-tax cost of these gifts, while a high price elasticity of charitable giving implies that the quantity of charitable donations is highly responsive to changes in the after-tax cost of these gifts.

A voluminous literature has developed over the past thirty years as economists have attempted to obtain reliable estimates of the price elasticity of charitable giving.⁴⁹ Although the earliest studies reported relatively low price elasticities of charitable giving,⁵⁰ suggesting that tax incentives are an inefficient means of funding charitable organizations,⁵¹ subsequent studies reported large negative price elasticities,⁵² suggesting that tax incentives may be a cost-effective method of funding charitable organizations.⁵³ More recent studies using different methodologies, however, have reported much lower estimates of price elasticities,⁵⁴ again calling into question the efficiency of tax incentives as a method of funding the charitable sector.⁵⁵ On this basis, it has been argued that if governments were to repeal their tax incentives for charitable giving and distribute the

⁴⁹ For summaries of this literature, see J.A. Johnson, "The Determinants of Charitable Giving with Special Emphasis on the Income Deduction under the Income Tax - A Survey of the Empirical Literature" (1981) 3 Can. Tax'n: J. Tax Pol'y 258; Charles T. Clotfelter, *Federal Tax Policy and Charitable Giving* (Chicago: University of Chicago Press, 1985) at 16-99; Scharf, Cherniavsky & Hogg, *supra* note 39 at 11-17; and Eleanor Brown, "Taxes and Charitable Giving: Is There a New Conventional Wisdom?" (Paper presented to the National Tax Association, Eighty-Ninth Annual Conference) (Chicago: National Tax Association, 1996) 153.

⁵⁰ See e.g. Taussig, *supra* note 38; Robert A. Schwartz, "Personal Philanthropic Contributions" (1970) 78 J. Pol'l Econ. 1264; and R.D. Hood, S.A. Martin & L.S. Osberg, "Economic Determinants of Individual Charitable Donations in Canada" (1977) 10 Can. J. Econ. 653.

⁵¹ See e.g. Rendall, *supra* note 23 at 158-59; Dennis B. Wolkoff, "Proposal for a Radical Alternative to the Charitable Deduction" [1973] U. Ill. L. F. 279 at 291-93; and Brooks, *Financing the Voluntary Sector*, *supra* note 28 at 18-21.

⁵² See e.g. Martin Feldstein, "The Income Tax and Charitable Contributions: Part I - Aggregate and Distributional Effects" (1975) 28 Nat'l Tax J. 81; Charles T. Clotfelter & C. Eugene Steuerle, "Charitable Contributions" in Henry J. Aaron & Joseph A. Pechman, eds., *How Taxes Affect Economic Behavior* (Washington, D.C.: Brookings Institution, 1980) 403; Harry Kitchen & Richard Dalton, "Determinants of Charitable Donations by Families in Canada: A Regional Analysis" (1990) 22 Applied Economics 285; and Harry Kitchen, "Determinants of Charitable Donations in Canada: A Comparison Over Time" (1992) 24 Applied Econ. 709.

⁵³ See e.g. Scharf, Cherniavsky & Hogg, *supra* note 39 at 9 and 14.

⁵⁴ See e.g. Richard Steinberg, "Taxes and Giving: New Findings" (1990) 1:2 *Voluntas* 76; Leonard E. Burman & William C. Randolph, "Measuring Permanent Responses to Capital-Gains Tax Changes in Panel Data" (1994) 84 Am. Econ. Rev. 794; William C. Randolph, "Dynamic Income, Progressive Taxes, and the Timing of Charitable Contributions" (1995) 103 J. Pol'l Econ. 709; Kevin Stanton Barrett, Anya M. McGuirk & Richard Steinberg, "Further Evidence on the Dynamic Impact of Taxes on Charitable Giving" (1997) 50 Nat'l Tax J. 321; and Pamela Greene & Robert McClelland, "Taxes and Charitable Giving" (2001) 54 Nat'l Tax J. 443.

⁵⁵ See e.g. Brooks, "The Tax Credit and Charitable Contributions", *supra* note 36 (concluding that "the best evidence tells us that the amount [of charitable giving stimulated by the Canadian tax credit] is considerably less than the government loses in revenue ... If the government were to repeal the tax credit and allocate the saved revenue through semi-autonomous government agencies to the voluntary sector, much of the charitable sector would have considerable additional revenue" at 471-72).

revenue savings in the form of direct grants to charitable organizations “much of the charitable sector would have considerable additional revenue.”⁵⁶

b. Rationality, controllability, accountability, and transparency

A second objection to tax incentives as a way of subsidizing charitable organizations is that these tax expenditures are not subject to the usual criteria applied to government spending, including the rational allocation of resources among competing priorities, control over the total amount expended, accountability for these expenditures to Parliament and the electorate, and transparency in the goals, costs, and beneficiaries of the expenditures.⁵⁷ For example, with respect to the allocation of charitable gifts, Neil Brooks concludes that:

Under the present tax credit for charitable contributions, the total level of expenditures ... to various medical research projects depend largely on competing public fund-raising drives. One could hardly imagine a less appropriate way to decide between—for example, muscular dystrophy, cancer, heart and stroke, trauma, and mental disability, say, than to base the decision on the “pay-off” from competing publicity campaigns.⁵⁸

In addition, he suggests that unlike government spending, few people plan their charitable contributions:

Instead they respond to family or friends’ medical histories, door-to-door collections, the availability of raffle tickets, or the sponsoring of someone in an event without seriously weighing the relative seriousness of the cause or the effectiveness of the particular charitable organization.⁵⁹

With respect to the control of costs, Brooks continues, tax incentives make it extremely difficult for the government to determine the total amount it will have to spend, which will “depend on, among other things, any changes in the marginal tax rates, the enactment of other tax incentives, and the success of charities’ appeals.”⁶⁰ Finally, on the questions of accountability and transparency, he notes that charities’ activities are

⁵⁶ *Ibid.* at 472.

⁵⁷ See e.g. *ibid.* at 467-71. For leading criticisms of tax expenditures, see Surrey, *supra* note 21; and Stanley S. Surrey & Paul R. McDaniel, *Tax Expenditures* (Cambridge, Mass.: Harvard University Press, 1985).

⁵⁸ Brooks, “The Tax Credit and Charitable Contributions”, *supra* note 36 at 467-68.

⁵⁹ *Ibid.* at 469.

⁶⁰ *Ibid.*

“seldom subject to public scrutiny,” making it possible, according to the Canadian Security Intelligence Service (CSIS), for “about two dozen charitable groups in Canada” to fund “world-wide terrorism and ethnic conflict” without public knowledge.⁶¹

c. Pluralism

These objections pose serious challenges to an argument favouring tax incentives for charitable contributions as indirect subsidies to charitable organizations. Nonetheless, it is my view that they do not undermine the most basic rationale for such an incentive: to enable individuals to choose through their donations the charitable activities to which they wish to direct a public subsidy.⁶² To the extent that these indirect subsidies allow individuals to select the charitable activities they feel should receive public support without having to obtain the agreement of a political majority, they are generally preferable to direct sustaining grants in promoting the very diversity and innovation that accounts for the charitable sector’s unique advantages over the traditional public sector. Indeed, in the absence of an all-knowing legislator who can allocate all public revenues in the most rational and efficient way, there is often no better basis on which to subsidize charitable organizations than by the “votes” of charitable donors, however rational or irrational these votes may be.

As a result, even if tax incentives for charitable contributions are a less cost-effective method of subsidizing charitable organizations than direct government grants, there are good reasons to favour tax incentives on broader policy grounds.⁶³ Although it might be argued that direct matching grants are as consistent with pluralistic objectives as indirect tax expenditures, the latter are more likely than the former to withstand the

⁶¹ *Ibid.* at 470.

⁶² For a similar conclusion see Krever, *supra* note 21 at 11-13. For a more general discussion of the use of the tax system to vote on public spending decisions, see Saul Levmore, “Taxes as Ballots” (1998) 65 U. Chicago L. Rev. 387.

⁶³ See e.g. Hochman & Rodgers, *supra* note 45 (“[p]ublic policy involves much more than whether an additional dollar of subsidies can generate more than a dollar of charity” at 11). See also Colombo, *supra* note 37 (adding that estimates of the price elasticity of charitable giving may not provide an accurate measure of the relative cost-effectiveness of tax incentives and direct grants. It is not obvious that governments would collect the taxes that are foregone by tax incentives, and indisputable that the collection and distribution of these revenues to charitable organizations would involve additional administrative and compliance costs that should also be taken into account in any efficiency analysis at 684, n. 128). On the other hand, any measure of the cost-effectiveness of indirect subsidies in the form of tax incentives should also account for administrative costs incurred by charitable organizations to obtain private donations and administrative and compliance costs associated with the incentives themselves.

kinds of political controls that would undermine their effectiveness in promoting pluralism.⁶⁴ For all these reasons, it is possible to justify the use of tax incentives as indirect subsidies for charitable organizations.

Pluralism, of course, has its limits, and the funding of terrorist organizations is clearly outside the scope of this rationale for an indirect subsidy in the form of a tax incentive. Nonetheless, the funding of terrorist organizations is neither inconceivable where charitable organizations receive public funds through direct grants, nor inevitable where subsidies are delivered indirectly in the form of tax incentives. On the contrary, in either case, the key to ensuring that public funds are used for the public benefit lies in the regulation of the charitable sector through disclosure and reporting requirements, and periodic audits.⁶⁵ As with governments, public accountability does not necessarily turn on whether funds are spent directly or indirectly. Indeed, the practice of publishing regular tax expenditure budgets makes the annual cost of tax incentives as much a matter of public record and debate as the annual cost of direct spending programs.⁶⁶

3. Designing a Tax Incentive for Charitable Contributions

If the purpose of a tax incentive for charitable contributions is to provide an indirect subsidy to charitable organizations that produce quasi-

⁶⁴ See e.g. Bittker, "Propriety", *supra* note 22 (concluding that "I have very little confidence that a system of matching grants could be administered without administrative and congressional investigations, loyalty oaths, informal or implicit warnings against heterodoxy, and the other trappings of governmental support that the tax deduction has, so far, been able to escape" at 147-52); Goode, *supra* note 10 (considering it "unlikely" that a system of direct matching grants "would be as free of undesirable controls or would serve the values of pluralism as well" at 163); John G. Simon, "Charity and Dynasty Under the Federal Tax System" (1978) 5 Prob. Law. 1 (observing that "[t]he tax allowance method has at least the virtue that it does not call upon the government to play an active role in singling out the chosen few" at 82); Krever, *supra* note 21 (concluding that "a matching grant system cannot effectively promote the values of pluralism. If pluralist decision making in the allocation of the government funds for charitable purposes is to be preserved, proposals to replace the current tax expenditure with a matching grant system must be viewed with suspicion" at 21-25); and Evelyn Brody, "Charities in Tax Reform: Threats to Subsidies Overt and Covert" (1999) 66 Tenn. L. Rev. 687 (suggesting that "one of the reasons why we use the indirect tax subsidy approach is that we are a very heterogeneous society. As such, we find it difficult to agree on which functions to subsidize" at 757).

⁶⁵ See e.g. Lorne Sossin, "Regulating Virtue: A Purposive Approach to the Administration of Charities" in Phillips, Chapman & Stevens, *supra* note 5, 373 (indicating among other things that only 0.75 per cent of Canadian charities are audited on a regular basis, at 388-89). For a recent discussion of these issues, see Voluntary Sector Initiative, *Interim Report of the Joint Regulatory Table: Improving the Regulatory Environment for the Charitable Sector* (August, 2002), online: <http://www.vsi-isbc.ca/eng/regulations/pdf/interim_report_full.pdf> [Voluntary Sector].

⁶⁶ For the most recent tax expenditure budget in Canada, see Department of Finance, *Tax Expenditures and Evaluations 2002* (Ottawa: Department of Finance Canada, 2002) [Department of Finance, *Tax Expenditures*].

public goods and services, the design of the incentive should presumably advance this purpose. The elements of a tax incentive for charitable contributions include: the kinds of recipients' donations that should be eligible for the tax incentive, the types of contributions for which the incentive is available, and the structure of the tax benefit available to those making qualifying contributions to eligible recipients. A further issue concerns the existence of any limit on the extent to which donors may claim the tax benefit.

a. Eligible recipients

Beginning with the kinds of recipients that should be eligible for tax-preferred donations, the rationale for the incentive should presumably define the scope of its application. To the extent that the incentive is intended to subsidize the production of quasi-public goods and services by charitable organizations, therefore, it should be available for any contribution to a charitable organization involved in activities that provide quasi-public goods or services. Since the subsidy is designed to support only activities having a public benefit, however, it is reasonable to require eligible recipients to devote all of their resources to these activities, or related activities having a public benefit, and to deny or revoke eligibility to organizations engaging in other activities that are either detrimental to the public good or carried on primarily for private advantage. In order to ensure public accountability for these tax expenditures, it seems reasonable to enforce these requirements by regular audits and to require public reporting of revenues and disbursements by eligible recipients.⁶⁷

Although arguably clear in the abstract, the application of these principles to actual organizations involves often subtle distinctions between the concepts of public benefit, public detriment, and private advantage. While these distinctions are often easier to draw in the context of concrete cases, the pluralistic rationale for indirectly subsidizing charitable organizations through tax incentives suggests at least some guidelines for the interpretation of each of these concepts.

The pluralistic goals of the incentive suggest that public benefits should be broadly defined to include economic and non-economic goods as well as the promotion of non-majoritarian values. To the extent that pluralism itself is conceived as a public good, it seems reasonable to extend the concept of a public benefit to include the advancement of alternative belief systems, both spiritual and ideological. On this basis, one might also

⁶⁷ For a balanced discussion of reporting requirements for the charitable sector, see Voluntary Sector, *supra* note 65 at 7-17.

favour the inclusion of the “advancement of religion” as a charitable purpose⁶⁸ and question the so-called “doctrine of political purposes,” which denies charitable status to organizations aimed at promoting social change or a particular point of view.⁶⁹ Where the means or ends of this social change contradict the values of a free and democratic society, however, eligibility should be denied on the basis that the organization’s purposes or activities are detrimental to the public good. Obvious examples include the practice or promotion of discrimination⁷⁰ or terrorism.⁷¹

As for the concept of private advantage, the provision of quasi-public goods and services rationale suggests that recipient organizations should not be eligible where their aims and activities do not extend to a

⁶⁸ Jim Phillips, “Religion, Charity, and the Charter” in Phillips, Chapman & Stevens, *supra* note 5, 316 at 317 [Phillips, “Religion, Charity, and the Charter”]. Phillips discusses limitations in the Anglo-Canadian definition of “religion,” but concludes that any benefits from the pursuit of religious activities should be regarded as private and that “[i]n a secular age, there seems little justification for the state to assist the expression of that preference” at 335. Phillips also provides a thorough examination of this issue in Canadian law.

⁶⁹ For a discussion of this doctrine in the Canadian context, see Abraham Drassinower, “The Doctrine of Political Purposes in the Law of Charities: A Conceptual Analysis” in Phillips, Chapman & Stevens, *supra* note 5, 288 (accepting for the purposes of his analysis the distinction between charitable and political purposes, but regarding advocacy for social change to advance minimal conditions of human dignity as charitable and not political). For a recent effort by the Canadian revenue authorities to articulate the scope of the political purposes doctrine, see CCRA, Policy Statement CPS-022, “Political Activities” (2 September 2003), online: <<http://www.ccr-aadrc.gc.ca/tax/charities/policy/cps/cps-022-e.html>> [CCRA, “Political Activities”]. For a recent critique of the political purposes doctrine in the Canadian context see Richard Bridge, “The Law of Advocacy by Charitable Organizations: The Case for Change” (2002) 21 E.T.P.J. 92.

⁷⁰ See e.g. *Bob Jones University v. United States*, 461 U.S. 574 (1983) (in which the U.S. Supreme Court denied charitable status to a non-profit private school with a racially discriminatory admissions policy). For a similar issue in the Canadian context see *Canada Trust Co. v. Ontario Human Rights Commission* (1990), 74 O.R. (2d) 481 (C.A.) (in which the court struck down discriminatory provisions in a charitable trust as offensive to public policy). For a useful discussion of this decision and the manner in which values reflected in the *Canadian Charter of Rights and Freedoms* should be used to disqualify organizations from charitable status see Mayo Moran, “Rethinking Public Benefit: The Definition of Charity in the Era of the Charter” in Phillips, Chapman & Stevens, *supra* note 5, 251. For a critical evaluation of the U.S. Treasury Department’s power to deny or revoke charitable status on public policy grounds, see David A. Brennan, “The Power of the Treasury: Racial Discrimination, Public Policy, and ‘Charity’ in Contemporary Society” (2000) 33 U.C. Davis L. Rev. 389.

⁷¹ See *Act*, *supra* note 2, s. 168(3) and the *Charities Registration (Security Information) Act*, S.C. 2001, c. 41, s. 4(1)(a), which provides for the denial or revocation of charitable status where the Federal Court concludes on the basis of information presented to it—including intelligence information that need not be disclosed to the applicant or registered charity—that there are reasonable grounds to conclude that the applicant or registered charity “made, makes or will make available any resources, directly or indirectly” to an organization or person that “engages or will engage in terrorist activities.”

sufficiently large segment of the community to constitute a public benefit.⁷² Nor should an organization qualify as an eligible recipient where it diverts any of its resources to the personal benefit of its officers or members, since this result would contradict the purpose of the subsidy to provide public resources for public benefits. Although an organization's activities may be such that the immediate beneficiaries are small in number, its aims and activities should qualify for recognition where this targeted assistance furthers a broader public good. Such is the case, for example, with the traditional charitable purpose of the relief of poverty.⁷³

b. Qualifying contributions

The second issue in designing a tax incentive for charitable donations concerns the kinds of contributions that should qualify for support. In this respect, at least two decisions must be made. The first decision concerns the kinds of contributions for which the incentive is available, while the second concerns the character of a charitable contribution as distinct from other non-qualifying transactions with charitable organizations.

With respect to the first question, possible alternatives include the following: cash, property in kind, and services. While ease of administration might suggest that qualifying gifts should be limited to cash donations, which provide the greatest flexibility to the eligible recipient and need not be valued in order to determine the amount of the tax benefit, the purpose of indirectly subsidizing eligible recipients seems to oppose any such distinction. On the contrary, to the extent that the incentive is intended to subsidize charitable organizations, encouraging gifts of property in kind and services is also desirable.⁷⁴

⁷² See e.g. *Verge v. Somerville*, [1924] A.C. 496 (P.C.) [*Verge*] (concluding that in order to be charitable, an organization's purposes must be for "the benefit of the community or of an appreciably important class of the community" at 499). This requirement was adopted by the Supreme Court of Canada in *Guaranty Trust Co. of Canada v. M.N.R.*, [1967] S.C.R. 133 [*Guaranty Trust*]; and *Vancouver Society of Immigrant and Visible Minority Women v. M.N.R.*, [1999] 1 S.C.R. 10 [*Vancouver Society*].

⁷³ *Commissioners for the Special Purposes of the Income Tax v. Pemsel*, [1891] A.C. 531 at 583 (H.L.) [*Pemsel*]. The *Pemsel* classification of charitable purposes was approved by the Supreme Court of Canada in *Guaranty Trust*, *supra* note 72 at 141, and *Vancouver Society*, *supra* note 72 at 102-03.

⁷⁴ While some tax theorists object to any tax recognition for gifts of service on the basis that the donor obtains an implicit deduction through the non-taxation of the "imputed income" represented by the performance of services, this result is best explained in terms of a more basic principle against the taxation of imputed income from self-performed services. See the discussion in Duff, "Charitable Contributions", *supra* note 5 at 410. See also McDaniel, *supra* note 26 (suggesting that "federal assistance could match contributions in services just as it could contributions in cash" if it is desired "to encourage volunteer work" at 396).

The second question is logically addressed by examining the consideration, if any, moving from the recipient to the donor. Since the purpose of the tax incentive is to subsidize eligible recipients, albeit indirectly, the incentive should apply only to the extent that the value of the donor's gift exceeds the value of any consideration in return. Otherwise, the tax expenditure merely subsidizes the donor's personal consumption without providing any economic benefit to the recipient organization. Where the consideration moving from the recipient to the donor is nominal or intangible, as with public acknowledgement of a donor's gift, the indirect subsidy rationale still applies, since the minimal cost of this consideration leaves the recipient organization with the economic benefit that the tax incentive is designed to provide.⁷⁵ Nor should the donor's purpose in making the gift matter, so long as it confers an economic benefit on the recipient organization. Nonetheless, where the donor makes the gift for the purpose of producing income, it should not be possible to deduct the same amount as was claimed for the purpose of the tax incentive. Instead, the most logical approach would be to permit a deduction only for the net cost of the gift after deducting the amount of the tax benefit received on account of the incentive.⁷⁶

c. Tax benefit

The third element in the design of a tax incentive for charitable contributions is the specific form that the incentive should take. Here too, the design of the incentive should advance its underlying purpose of providing an indirect subsidy to charitable organizations producing quasi-public goods and services. More generally, to the extent that pluralism itself is regarded as a public good, the incentive should be designed to promote a diversity of organizations and perspectives by placing greater emphasis on the number of donors than the size of their donations.

Emphasizing the first of these objectives, some commentators have suggested that the amount of the tax benefit should vary according to the extent of the public benefit derived from the gift. According to Wayne Thirsk, for example:

⁷⁵ For a contrary view, see Colombo, *supra* note 37 (arguing that the rationale for subsidization does not exist where the availability of this quid pro quo overcomes a "free-riding tendency" on the part of potential contributors, at 697-701).

⁷⁶ If the incentive took the form of a flat-rate credit of 40 per cent, for example, a donor making a \$100 gift would obtain a credit of \$40, which would be subtracted from the amount of the gift to leave a deductible expense of \$60.

[I]t would be desirable to disaggregate within an expenditure category and confer different rates of credit on items that contribute different amounts of social benefit. Not all charitable activities, for example, may yield the same degree of social value, in which case a policy of differentiated tax credits is called for.⁷⁷

On this basis, it follows that a tax incentive for charitable contributions should provide larger tax benefits for gifts to organizations providing broader public benefits, and smaller tax benefits for gifts to organizations providing more localized benefits.

While this approach may be theoretically sound, and feasible in some contexts, it is likely to founder on the actual measurement of public benefits, which can depend on value judgments that are often difficult to reconcile.⁷⁸ More importantly, since the purpose of an indirect subsidy in the form of a tax incentive is to promote pluralism in the allocation of public funds, any decision to favour some activities over others is arguably incompatible with this type of subsidy as opposed to direct government grants. Indeed, to the extent that pluralism itself is regarded as a public good, a tax incentive for charitable contributions should not discriminate among different activities or organizations, except to deny charitable status to organizations the aims or activities of which contradict the values of a free and democratic society.

From this perspective, one might also question the structure of a deduction for charitable contributions, which differentiates among donors by providing a larger tax subsidy for contributions from high-income donors than low-income donors and no subsidy for contributions from donors whose incomes are too low to pay any tax. To the extent that charitable contributions operate as "votes" to direct public subsidies to the organizations of the donor's choosing,⁷⁹ a deduction weighs the votes of high-income donors more heavily than those of lower income donors and completely disenfranchises the lowest income donors who pay no tax. Rather than promoting genuine pluralism, therefore, a deduction is apt to

⁷⁷ *Supra* note 10 at 41-42. See also Hochman & Rodgers, *supra* note 45 (arguing that "[t]he proper level of the tax credit depends ... on the 'external' content of the benefits that the charity-financed activities confer; it depends, in other words, on the relationship between the marginal evaluations of the primary sharing group, namely, voluntary donors, and the community-at-large" at 14); and Scharf, Cherniavsky and Hogg, *supra* note 39 (suggesting that "we should try to encourage donations to charities that provide goods or services to a large number of consumers" at 9).

⁷⁸ See e.g. Wolkoff, *supra* note 51 (most religious gifts "help maintain the donors' congregations" and are "directed at satisfying the needs of the donor, not at satisfying the needs of society at large" at 288); and Bromley, *supra* note 35 ("[r]eligious activities are justifiably 'charitable' on the basis that they are beneficial to the community as a whole because they contribute to bettering the conduct and character of citizens" at 14).

⁷⁹ Levmore, *supra* note 62.

foster a kind of “philanthropic paternalism,” where the mix of goods and services provided by the charitable sector is shaped more by an affluent minority than by the community as a whole.

For this reason, a tax incentive for charitable contributions should ideally take the form of a tax credit or rebate, the value of which does not vary according to the donor’s level of income.⁸⁰ In addition, the credit should be fully refundable in order to ensure that the subsidy is available for donors whose incomes are too low to pay tax.⁸¹ The credit might also include a declining rate structure based on the amount claimed, thereby promoting a more genuine pluralism by providing a larger subsidy for small and medium-sized donations and a smaller subsidy for large donations.⁸² If this approach were adopted, however, it might be necessary to prohibit the deduction of gifts made for the purpose of earning income.

d. Limit

A final issue in the design of a tax incentive for charitable giving involves the existence of an overall limit on the amount that donors could claim every year. Since more affluent donors are able to make larger contributions to charitable organizations than donors with less income or wealth, a tax benefit based solely on the amount contributed allows more affluent donors to direct more public funds to organizations of their choosing than less affluent donors. In addition to a declining rate structure, therefore, a tax incentive for charitable contributions might reasonably impose a limit on the maximum tax benefit that may be claimed.⁸³

One such approach, currently employed in Canada and the United States, is to limit the total amount of charitable contributions for which a tax credit could be claimed to a fixed percentage of the donor’s income for

⁸⁰ For a similar argument to this effect, see Krever, *supra* note 21 (criticizing the “upside-down” character of a deduction and recommending a flat-rate “tax rebate” which “could be used to offset part of the taxpayer’s tax liability” at 20, 25).

⁸¹ For similar arguments, see McDaniel, *supra* note 26 (suggesting that society would be “greatly enhanced” by extending the pluralism of a tax incentive for charitable contributions to 100 per cent of contributors, at 391); Brooks, *Financing the Voluntary Sector*, *supra* note 28 (favouring a refundable tax credit at 23-24).

⁸² A good example might be the political contributions tax credit in *Act*, *supra* note 2, s. 127(3), which, although non-refundable, provides for a credit of 75 per cent of the first \$200 contributed to a registered political party or candidate in a taxation year, 50 per cent of the next \$350 contributed in the year, and 33 1/3 per cent of the next \$525, for a maximum credit against tax otherwise payable of \$500 on annual contributions of \$1,075.

⁸³ See e.g. Brooks, *Financing the Voluntary Sector*, *supra* note 28 (“if the pluralism argument is to be taken seriously, the maximum tax credit available to each taxpayer could be limited” at 23-24).

the year.⁸⁴ In this way, donors would be limited not only in the extent to which they could direct public funds to their preferred activities, but also in their ability to avoid all tax liability by making charitable gifts the total value of which exceeds their annual income. As Peter Wiedenbeck explains, an income-related ceiling on total gifts that may be claimed "reflects a judgment ... that although charitable contributions are important and should be encouraged, every taxpayer should bear part of the burden of supporting the government."⁸⁵ In this respect, he adds, such a limit functions "as a mechanism to effectuate an appropriately limited consumer sovereignty over social service expenditures."⁸⁶

While this approach might make sense for a tax incentive delivered in the form of a deduction or non-refundable credit, it seems incompatible with the main objective of a refundable credit of providing an equal tax benefit for charitable contributions made by all donors irrespective of their incomes. Since an income-related ceiling along these lines could limit the tax benefit available to donors with little or no taxable incomes, it could actually undermine the genuine pluralism that a refundable tax credit is designed to promote. A more appropriate limit on the maximum tax benefit available might be based on the aggregate amount donated over a specific period of time (for example, up to \$10,000 of tax-assisted donations per year) or the amount of the benefit itself. In New Zealand, for example, the introduction of a new income tax in 1976 included a tax incentive for charitable contributions providing a credit of 50 per cent up to a maximum tax savings of \$175.⁸⁷ To the extent that this limit prevents a donor's estate from claiming credits in the year of the donor's death, however, the incentive might reasonably permit a limited carryback for this purpose.

III. PRACTICE: TAX INCENTIVES FOR CHARITABLE CONTRIBUTIONS IN CANADA

As explained in the introduction, the Canadian income tax recognizes contributions to charitable organizations by permitting: a

⁸⁴ In Canada, this percentage was originally set at 10 per cent of the donor's income for the year, but was increased to 20 per cent in 1972, 50 per cent in 1996, and 75 per cent in 1997. In the United States, the ceiling was originally 15 per cent of the donor's income, but was subsequently increased to 50 per cent. See the discussion of these ceilings in Duff, "Charitable Contributions", *supra* note 5 at 420-23.

⁸⁵ Peter J. Wiedenbeck, "Charitable Contributions: A Policy Perspective" (1985) 50 Mo. L. Rev. 85 at 115.

⁸⁶ *Ibid.* at 117.

⁸⁷ Krever, *supra* note 21 at 27.

deduction in computing the donor's net income where these gifts are made for the purpose of gaining or producing income from a business; a deduction in computing taxable income where the gift is made by a corporation; a non-refundable tax credit where the gift is made by an individual; and full or partial exemptions from capital gains tax otherwise payable where the subject matter of the gift consists of qualifying cultural property, publicly traded securities, or ecologically sensitive land. While the first method of tax recognition is consistent with ordinary principles for the computation of a taxpayer's income from a business, the others are best conceived as tax incentives or tax expenditures that provide an indirect subsidy to eligible recipients by encouraging donors to make qualifying gifts. The following sections examine the elements of these three tax incentives, considering the kinds of recipients of donations that are eligible for tax recognition, the types of gifts that qualify for tax recognition, and the structure of the tax benefit available under each incentive.⁸⁸

A. *Eligible Recipients*

Although different statutory rules govern the deduction for corporate donations, the credits for individual donations, and the full or partial capital gains exemptions for gifts of cultural property, publicly traded securities, and ecologically sensitive land, all share similar definitions of eligible recipients. According to subsection 110.1(1) of the *Act*, for example, corporations may claim a deduction in respect of the following categories of gifts:

- gifts of ecologically sensitive land (as certified by the Minister of the Environment) to "Her Majesty in right of Canada or a province or a municipality in Canada," or to "a registered charity one of the main purposes of which is ... the conservation and protection of Canada's heritage";
- gifts of qualifying cultural property (other than ecologically sensitive land), as determined by the Canadian Cultural Property Export Review Board, to "an institution or a public authority in Canada that was, at the time the gift was made, designated" as an eligible recipient under subsection 32(2) of the *Cultural Property Export and Import Act*;
- gifts, other than gifts of ecologically sensitive land or qualifying cultural property, to "Her Majesty in right of Canada or a province" that were made before February 19, 1997; and

⁸⁸ For a useful survey of these elements for the tax treatment of charitable contributions in Canada, see David P. Stevens, "Update on Charity Taxation" (2002) 28 Report of proceedings of the annual tax conference convened by the Canadian Tax Foundation 1.

- gifts, other than gifts of ecologically sensitive land, qualifying cultural property, or to the federal government or a province, to:
 - (i) “a registered charity,”
 - (ii) “a registered Canadian amateur athletic association,”
 - (iii) a housing corporation in Canada described in s. 149(1)(i) as being “constituted exclusively for the purpose of providing low-cost housing accommodation for the aged, no part of the income of which was payable to, or was otherwise available for the personal benefit of, any proprietor, member or shareholder thereof,”
 - (iv) “a municipality in Canada,”
 - (v) “the United Nations or an agency thereof,”
 - (vi) “a university outside Canada that is prescribed to be a university the student body of which ordinarily includes students from Canada,”
 - (vii) “a charitable organization outside Canada to which Her Majesty in right of Canada has made a gift in the year or in the 12-month period preceding the year,” or
 - (viii) “Her Majesty in right of Canada or a province.”

An identical list of eligible recipients appears in section 118.1, which governs the non-refundable credit for individual gifts. Similarly, subparagraph 39(1)(a)(i.1), which exempts capital gains on gifts of qualifying cultural property, applies only where the gift is made to an institution or public authority designated by the *Cultural Property Export and Import Act*. Likewise, subparagraphs 38(a.1) and (a.2) of the *Act*, which provide a partial exemption from capital gains on gifts of publicly traded securities and ecologically sensitive land, apply only where the gift is made to a “qualified donee,” defined in subsection 149.1(1) as all of the recipients listed above except the designated institution or public authority applicable for gifts of cultural property.

Of these eligible recipients, the most important category is a “registered charity,” defined in subsection 248(1) of the *Act* as:

- (a) a charitable organization, private foundation or public foundation, within the meanings assigned by subsection 149.1(1), that is resident in Canada and was either created or established in Canada, or
- (b) a branch, section, parish, congregation or other division of an organization or foundation described in paragraph ... (a), that is resident in Canada and was either created or established in Canada and that receives donations on its own behalf,

that has applied to the Minister in prescribed form for registration, and is at that time registered as a charitable organization, private foundation or public foundation.

As a registered charity, a charitable organization or foundation is required to file an annual information return including schedules and financial statements disclosing the charity's sources of income and the nature of its disbursements and expenditures.⁸⁹ Failure to file this return is a ground for revoking charitable status.⁹⁰

Section 149.1 of the *Act* contains the statutory rules defining charitable organizations and foundations. According to the definitions in subsection 149.1(1), a "charitable organization" means "an organization, whether or not incorporated":

- (a) all the resources of which are devoted to charitable activities carried on by the organization itself,
- (b) no part of the income of which is payable to, or is otherwise available for, the personal benefit of any proprietor, member, shareholder, trustee or settlor thereof, [and]
- (c) more than 50 per cent of the directors, trustees, officers or like officials of which deal with each other and with each of the other directors, trustees, officers or officials at arm's length ...

while a "charitable foundation" means

a corporation or trust that is constituted and operated exclusively for charitable purposes, no part of the income of which is payable to, or otherwise available for, the personal benefit of any proprietor, member, shareholder, trustee or settlor thereof, and that is not a charitable organization.

A charitable foundation is classified as a "public foundation" where a majority of the foundation's "directors, trustees, officers or like officials deal with each other and each of the other directors, trustees, officers or officials at arm's length," provided that no more than 50 per cent of the foundation's capital was contributed either by a single person or by members of a group who do not deal with each other at arm's length.⁹¹ Otherwise, the charitable foundation is classified as a "private foundation."

⁸⁹ *Supra* note 2, s. 149.1(14). See CCRA, T4033, "Completing the Registered Charity Information Return" (2001), online: <<http://www.ccr-aadrc.gc.ca/E/pub/tg/t4033/t4033-02e.pdf>>.

⁹⁰ *Supra* note 2, s. 168(1)(c).

⁹¹ *Ibid.*, s. 149.1(1). For foundations registered before February 16, 1984, the limit on contributions of capital by a single person or group of persons not dealing with each other at arm's length is 75 per cent rather than 50 per cent.

Because the opportunities for abuse are greater, private foundations are subject to more stringent regulatory requirements than public foundations.⁹²

Whereas the distinction between a public and private foundation turns on the extent to which it is controlled by a single person or related group, the distinction between a charitable organization and a charitable foundation generally turns on the manner in which it engages in charitable pursuits. As a general rule, charitable organizations must devote their resources to "charitable activities" that they themselves carry on. However, subsection 149.1(6) relaxes this requirement by considering a charitable organization to be devoting its resources to charitable activities where it carries on a related business, disburses not more than 50 per cent of its income to qualified donees, or disburses income to a registered charity with which it is "associated."⁹³ In contrast, charitable foundations are merely required to operate for "charitable purposes," a term that subsection 149.1(1) specifically defines to include "the disbursement of funds to qualified donees." In general, therefore, charitable organizations engage in charitable activities themselves, while charitable foundations operate for charitable purposes by disbursing funds to charitable organizations and other qualified donees.

Notwithstanding this distinction between charitable organizations and charitable foundations, the *Act* requires both types of registered charity to be exclusively charitable, devoting "all" of their "resources" to charitable activities in the case of charitable organizations, and operating "exclusively" for charitable purposes in the case of charitable foundations. Where a charitable foundation or organization devotes "substantially all of its resources" to charitable purposes or activities, however, subsections 149.1(6.1) and (6.2) of the *Act* permit the charity to devote part of its resources to "political activities," provided that they are "ancillary and incidental" to the foundation's purposes or the organization's activities and "do not include the direct or indirect support of, or opposition to, any political party or candidate for public office."⁹⁴ More generally, judicial

⁹² See *ibid.*, ss. 149.1(3) and (4), which list various circumstances in which the Minister may revoke the registration of a public foundation or a private foundation.

⁹³ According to the *Act*, *ibid.*, s. 149.1(7), the Minister may on application designate a registered charity as a charity associated with one or more registered charities where "the Minister is satisfied that the charitable aim or activity of each of the registered charities is substantially the same"

⁹⁴ The CCRA allows a charity to devote as much as 10 per cent of its resources to political activities and still satisfy the requirement that "substantially all" of its resources be devoted to purely charitable activities. Recognizing that this policy "may have a negative impact on smaller charities" whose ability to conduct ancillary political activities may be thus limited, the CCRA proposes to be more forgiving of smaller charities by increasing the threshold to 20 per cent for registered charities with annual incomes

decisions have held that the pursuit of purposes that are not themselves charitable, but “incidental to” or “a means to the fulfilment of” other charitable purposes will not deprive a foundation or organization of charitable status.⁹⁵

Since the *Act* does not, aside from these provisions, define the terms “charitable activities” and “charitable purposes,” Canadian courts have generally sought guidance in the common law of trusts, which admits charitable purpose trusts as an exception to the general rule that a purpose trust is invalid. Although the definition of a charitable organization mentions charitable activities, not purposes, the Supreme Court of Canada has downplayed the distinction, stating that “it is really the purpose in furtherance of which an activity is carried out, and not the character of the activity itself, that determines whether or not it is of a charitable nature.”⁹⁶ Where an organization is established for a charitable purpose, however, the Court has also emphasized that it is necessary to consider the activities carried on by the organization in order to ensure that they are “in furtherance of” the charitable purpose.⁹⁷

The traditional starting point for judicial interpretation of charitable purposes is Lord Macnaghten’s statement in *Pemsel*:

“Charity” in its legal sense comprises four principal divisions: trusts for the relief of poverty; trusts for the advancement of education; trusts for the advancement of religion; and trusts for other purposes beneficial to the community, not falling under any of the preceding heads.⁹⁸

Superimposed on these categories, however, is a further requirement that the purpose of the trust must be “for the benefit of the community or of an appreciably important class of the community.”⁹⁹ Although applicable to each of the *Pemsel* categories, this additional requirement is particularly relevant to the fourth category, “other purposes beneficial to the community,” since, as Justice Gonthier suggested in

of less than \$50,000, 15 per cent for those with incomes between \$50,000 and \$100,000, and 12 per cent for those with incomes between \$100,000 and \$200,000. See CCRA, “Political Activities”, *supra* note 69, s. 9. The CCRA is also willing to accommodate organizations whose relative political spending may spike in a particular year if the average over several years would be within the parameters. See *ibid.*, s. 9.1.

⁹⁵ *British Launderers’ Research Association v. Borough of Hendon Rating Authority*, [1949] 1 K.B. 462 (C.A.), cited with approval by the Supreme Court of Canada in *Guaranty Trust*, *supra* note 72 at 143.

⁹⁶ *Vancouver Society*, *supra* note 72 at 108.

⁹⁷ *Ibid.* at 131.

⁹⁸ *Supra* note 73 at 583.

⁹⁹ *Verge*, *supra* note 72 at 499, cited with approval in *Guaranty Trust*, *supra* note 72 at 141.

dissent in *Vancouver Society*, "under the first three heads, public benefit is essentially a rebuttable presumption, whereas under the fourth head it must be demonstrated."¹⁰⁰

In determining whether a purpose is charitable under the fourth head, English and Canadian courts have held that it is necessary to determine not only whether the purpose is of benefit to the community, but also whether it is beneficial "in a way that the law regards as charitable."¹⁰¹ In making this determination, they have generally referred to the preamble of the *Charitable Uses Act, 1601*,¹⁰² commonly called the *Statute of Elizabeth*, which listed a number of activities regarded as charitable at the time.¹⁰³ Traditionally, courts and commentators often emphasized the "spirit and intendment" of the preamble,¹⁰⁴ and attempted to articulate a common principle to the preamble's list of charitable activities.¹⁰⁵ In contrast, most

¹⁰⁰ *Vancouver Society*, *supra* note 72 at 45.

¹⁰¹ *D'Aguiar v. Guyana Commissioner of Inland Revenue*, [1970] T.R. 31 (P.C.) [*D'Aguiar*], cited with approval in *Vancouver Society*, *supra* note 72 at 121. Among the reasons why the Court affirmed this additional requirement in the *Vancouver Society* case is the need to distinguish between charitable organizations donations to which are eligible for a corporate deduction or individual credit, and non-profit organizations, which are tax-exempt but not eligible recipients for the purpose of the deduction or credit. Since the *Act*, *supra* note 2, s. 149(1)(l) defines a non-profit organization as a non-charitable "club, society or association" that was "organized and operated exclusively for," among other things, "social welfare," the Court concluded that the statutory distinction between charitable and non-profit organizations would collapse if "public benefit" alone were to qualify as a charitable purpose under the fourth *Pemsel* category, *supra* note 73.

¹⁰² 43 Eliz. 1, c. 4.

¹⁰³ A modern rendition of the charitable activities listed in the preamble appears in *McGovern v. A.G.*, [1982] Ch. 321 at 332: "the relief of aged, impotent, and poor people ... the maintenance of sick and maimed soldiers and mariners, schools of learning, free schools, and scholars in universities ... the repair of bridges, ports, havens, causeways, churches, seabanks, and highways ... the education and preferment of orphans ... the relief, stock, or maintenance of houses of correction ... marriage of poor maids ... supportation, aid, and help of young tradesmen, handicraftsmen, and persons decayed ... the relief or redemption of prisoners or captives, and the aid or ease of any poor inhabitants concerning payment of fifteens, setting out of soldiers, and other taxes."

¹⁰⁴ See e.g. *National Anti-Vivisection Society v. Inland Revenue Commissioners*, [1948] A.C. 31 (H.L.) at 63-64, cited with approval in *Native Communications Society of B.C. v. M.N.R.* (1986), 86 D.T.C. 6357 (F.C.A.) at 6357.

¹⁰⁵ See e.g. Spencer G. Maurice & David B. Parker, *Tudor on Charities*, 7th ed. (London: Sweet & Maxwell, 1984) at 90-91 (concluding that "general public utility, with the strongest possible emphasis on the adjective "general," was the charitable characteristic possessed in common by the purposes recited in the preamble" at 92); E. Blake Bromley, "Contemporary Philanthropy - Is the Legal Concept of "Charity" Any Longer Adequate?" in Donald W.M. Waters, ed., *Equity, Fiduciaries and Trusts 1993* (Toronto: Carswell, 1993) 59 at 65-66 (suggesting that the preamble is best viewed as an agenda for social improvement); and Gonthier J.'s dissenting judgment in *Vancouver Society*, *supra* note 72 (proposing as common principles of all charities: "(1) voluntariness (or ... altruism, that is, giving to third parties without receiving anything in return other than the pleasure of giving); and (2) public welfare or benefit in an objectively measurable sense" at 43).

modern judicial decisions proceed on an incremental basis, considering the trend of judicial decisions regarding objects as charitable under this category and asking “whether, by reasonable extension or analogy, the instant case may be considered to be in line with these.”¹⁰⁶ This incremental approach is extremely resistant to evolutionary expansion, as illustrated by the majority decision in *Vancouver Society*,¹⁰⁷ which denied charitable status under the fourth head to a society devoted to helping immigrant women find employment or self-employment,¹⁰⁸ notwithstanding earlier cases that had sanctioned charitable trusts for the purpose of aiding the settlement of poor or persecuted immigrants.¹⁰⁹ As Mayo Moran and Jim Phillips have observed: “If one cannot move from poor or persecuted immigrants to female visible minority immigrants (let alone immigrants generally) one cannot get very far through analogy.”¹¹⁰

For the purposes of this article there is no need to examine the other *Pemsel* categories in detail, or to review Canadian cases on the legal definition of a charity.¹¹¹ In general, recent decisions have adopted expansive interpretations of the “relief of poverty” and “advancement of

¹⁰⁶ *D’Aguir, supra* note 101 at 33, cited with approval by Iacobucci J. in *Vancouver Society, supra* note 72 at 121.

¹⁰⁷ *Vancouver Society, ibid.*

¹⁰⁸ Although considering the society’s purposes non-charitable under the fourth category, the majority regarded its purposes as charitable under an expansive view of the second category involving the “advancement of education.” Notwithstanding this conclusion, it denied the society charitable status on the basis that it was not clear that “all of its resources” would be devoted to this purpose. See *ibid.* at 138.

¹⁰⁹ See e.g. *In Re Wallace*, [1908] V.L.R. 636 (S.C.) (trust to pay passage money to immigrants from an English town to Melbourne); *Re Stone* (1970), 91 N.S.W.W.N. 704 (trust for the promotion of Jewish settlement in Israel); and *Re Morrison* (1967), 111 Solicitor’s L. J. 758 (Ch. D.) (trust for the assistance of refugees).

¹¹⁰ Mayo Moran & Jim Phillips, “Charity and the Income Tax Act: The Supreme Court Speaks” in Phillips, Chapman & Stevens, *supra* note 5, 343 at 364. For other commentaries on the decision, see Deborah J. Lewis, “A Principled Approach to the Law of Charities in the Face of Analogies, Activities and the Advancement of Education” (2000) 25 Queen’s L.J. 679; David Stevens, “*Vancouver Society of Immigrant and Visible Minority Women v. M.N.R.*” (2000) 15:2 Philanthrop. 4; Arthur B. Drache, “*Vancouver Immigrant Women: The First Judicial Interpretation*” (2000) 15:2 Philanthrop. 14; and Wolfe D. Goodman, “A Personal View of the *Vancouver Society* Decision” (2000) 15:2 Philanthrop. 20.

¹¹¹ For a detailed discussion of the *Pemsel* categories see Ontario Law Reform Commission, *Report on the Law of Charities* (Toronto: Ontario Law Reform Commission, 1996) at 159-228. See also Australia, *Report of the Inquiry into the Definition of Charities and Related Organizations* (Canberra: Commonwealth of Australia, 2001). For a useful survey of Canadian cases on the law of charity see Jim Phillips, “The Federal Court of Appeal and the Legal Meaning of Charity: Review and Critique” in Phillips, Chapman & Stevens, *supra* note 5, 219.

education" categories,¹¹² although the latter does not extend to public education or advocacy that is designed to promote a particular point of view.¹¹³ With respect to the third category, "advancement of religion," the courts adhere to a traditional conception, generally insisting on the existence of a "deity" and distinguishing between religion proper and "ethical systems of belief."¹¹⁴ Consistent with subsections 149.1(6.1) and (6.2) of the *Act*, which permit "ancillary and incidental" political activities, Canadian courts distinguish between charitable and political activities or purposes, denying charitable status where the activities or purposes of the organization or foundation advocate social change or promote a particular point of view.¹¹⁵ Finally, new subsection 168(3) of the *Act* provides for the revocation of charitable status where a Federal Court confirms the decision of the Solicitor General and the Minister of National Revenue that the organization or foundation "has made, makes, or will make available any resources, directly or indirectly," to an organization or person that "engages in, or will engage in terrorist activities."¹¹⁶

¹¹² See e.g. *Inland Revenue Commissioners v. Oldham Training and Enterprise Council* (1996), 69 T.C. 231 (Ch. D.) (regarding as charitable under the "relief of poverty" heading an organization the purpose of which was to provide services to the poor to enable them to become economically independent); and *Vancouver Society*, *supra* note 72 (rejecting earlier Canadian understandings of the "advancement of education" as "formal training of the mind" or the "improvement of a useful branch of human knowledge").

¹¹³ See e.g. *Positive Action Against Pornography v. M.N.R.* (1988), 88 D.T.C. 6186 (F.C.A.); *Toronto Volograd Committee v. M.N.R.* (1988), 88 D.T.C. 6192 (F.C.A.); *Briarpatch Incorporated v. The Queen* (1996), 96 D.T.C. 6294 (F.C.A.); *Interfaith Development Education Association v. M.N.R.* (1997), 97 D.T.C. 5424 (F.C.A.); and *Alliance for Life v. M.N.R.* (1999), 99 D.T.C. 5228 (F.C.A.). The CCRA has recently indicated that it is willing to expand its view of these categories to include organizations that might otherwise not qualify on the grounds that they are "political" in nature. See CCRA, Policy Statement CPS-021, "Registering Charities the Promote Racial Equality" (2 September 2003) online: <<http://www.ccra-adrc.gc.ca/tax/charities/policy/cps-021-e.html>>.

¹¹⁴ See e.g. *Bowman v. Secular Society*, [1917] A.C. 406 (H.L.); *R v. Registrar-General, Ex Parte Segerdal*, [1970] 2 Q.B. 697 (C.A.); and *Re South Place Ethical Society*, [1980] 1 W.L.R. 1565 (Ch.). For a useful discussion of this category in the Canadian context, see Phillips, "Religion, Charity, and the Charter", *supra* note 68 at 335.

¹¹⁵ See e.g. *Challenge Team v. Revenue Canada* (2000), 2000 D.T.C. 6242 (F.C.A.).

¹¹⁶ *Charities Registration (Security Information) Act*, S.C. 2001, c. 41, ss. 4(1), 7(1). For a critical evaluation of this legislation, see David G. Duff, "Charitable Status and Terrorist Financing: Rethinking the Proposed Charities Registration (Security Information) Act" in Ronald J. Daniels, Patrick Macklem & Kent Roach, *The Security of Freedom: Essays on Canada's Anti-Terrorism Bill* (Toronto: University of Toronto Press, 2001) 321.

B. Qualifying Gifts

Also common to each of the tax incentives available for charitable contributions is the requirement that the donor have made a “gift” to the eligible recipient. In this circumstance, paragraphs 38(a.1) and (a.2) and subparagraph 39(1)(a)(i.1) of the *Act* exempt part or all of any gain on the disposition of publicly traded securities, ecologically sensitive land, or cultural property, while sections 110.1 and 118.1 permit the donor to claim a deduction or credit in respect of the “fair market value” of the gift. As a general rule, fair market value refers to “the highest price available estimated in terms of money which a willing seller may obtain for the property in an open and unrestricted market from a willing, knowledgeable purchaser acting at arm’s length.”¹¹⁷ Although a number of reported cases consider the fair market value of particular gifts,¹¹⁸ the key interpretive issues for the purposes of this article concern the characterization of a gift for the purpose of a tax incentive for charitable contributions and the kinds of contributions that can be the subject matter of such a gift.

In the absence of a statutory definition of the word gift, Canadian courts have looked to private law concepts in order to apply these provisions of the *Act*. In common law provinces, courts have defined a gift as “a voluntary transfer of property from one person to another gratuitously and not as the result of a contractual obligation without anticipation or

¹¹⁷ *Re Mann Estate*, [1972] 5 W.W.R. 23 at 27 (B.C. S.C.), aff’d [1973] 4 W.W.R. 223 (B.C. C.A.), aff’d [1974] 2 W.W.R. 574 (S.C.C.)

¹¹⁸ Several of these cases involve so-called “art flips” in which taxpayers acquired property at one price and immediately thereafter donated the property to an eligible recipient at an appraised value significantly in excess of its purchase price, benefitting from the exemption on gifts of cultural property under the *Act*, *supra* note 2, s. 39(1)(a)(i.1) or the rule in s. 46(1)(a) deeming the adjusted cost base of “personal-use property” to be the greater of \$1,000 and the amount otherwise determined. See e.g. *Friedberg v. The Queen* (1991), 92 D.T.C. 6031 (F.C.A.) [*Friedberg*]; *Arvisais v. M.N.R.* (1992), 93 D.T.C. 506 (T.C.C.); *Ball v. The Queen*, [1993] 2 C.T.C. 2474 (T.C.C.); *Gardner v. The Queen*, [1993] 2 C.T.C. 2480 (T.C.C.); *Bouchard v. The Queen*, [1993] 2 C.T.C. 2778 (T.C.C.); *Paradis v. The Queen* (1996), [1997] 2 C.T.C. 2557 (T.C.C.); *Marcoux-Côté v. The Queen* (2000), 2000 D.T.C. 6615 (F.C.A.); *Whent v. The Queen* (1999), 2000 D.T.C. 6001 (F.C.A.); *Aikman v. The Queen* (2002), 2002 D.T.C. 6874 (F.C.A.); *Duguay v. The Queen* (2000), 2000 D.T.C. 6620 (F.C.A.); *Langlois v. The Queen* (2000), 2000 D.T.C. 6612 (F.C.A.); and *Berubé v. Canada*, [2002] 4 C.T.C. 2147 (T.C.C.). In response to these kinds of transactions, s. 118.1(10) was added to the *Act* by *Income Tax*, 1990, S.C. 1990, c. 35, s. 10 to authorize the Canadian Cultural Property Export Review Board to determine the fair market value of gifts of cultural property, and s. 46(5) was added by *Income Tax*, 2000, S.C. 2001, c. 17, s. 31 to exclude from the deemed adjusted cost base rule in s. 46(1)(a) “property acquired by the taxpayer, or a person with whom the taxpayer does not deal at arm’s length, in circumstances in which it is reasonable to conclude that the acquisition of the property relates to an arrangement, plan or scheme that is promoted by another person or partnership and under which it is reasonable to conclude that the property will be the subject of a gift to which subsection 110.1(1) or ... subsection 118.1(1) applies.”

expectation of material benefit.”¹¹⁹ In Quebec, on the other hand, a gift is defined as “a contract by which a person, the donor, transfers ownership of property by gratuitous title to another person, the donee.”¹²⁰ According to section 8.1 of the federal *Interpretation Act*:

Both the common law and the civil law are equally authoritative and recognized sources of the law of property and civil rights in Canada and, unless otherwise provided by law, if in interpreting an enactment it is necessary to refer to a province's rules, principles or concepts forming part of the law of property and civil rights, reference must be made to the rules, principles and concepts in force in the province at the time the enactment is being applied.¹²¹

As a result, while the civil law concept of a gift applies in Quebec, the common law concept applies in the rest of Canada.¹²²

To the extent that the common law concept requires a “voluntary transfer” for “no benefit or consideration,” while the civil law concept requires a “contract” to transfer ownership, the *Act* appears to mandate different requirements for qualifying gifts in Quebec than in the rest of the country. Indeed, while the courts in Quebec have recognized a contract of donation between a charity and a donor as a valid gift,¹²³ the status of such donations in common law provinces is uncertain.¹²⁴ More significantly, while at least one Quebec decision has affirmed the existence of a gift where a donor purchased tickets for a benefit concert and reception at a

¹¹⁹ *Woolner v. The Queen* (1999), 99 D.T.C. 5722 (F.C.A.) at 5723. For similar definitions see *The Queen v. Zandstra* (1974), 74 D.T.C. 6416 (F.C.T.D.) [*Zandstra*] at 6419; *McBurney v. The Queen*, [1985] 85 D.T.C. 5433 (F.C.A.) [*McBurney*] at 5435-36; *Burns v. M.N.R.* (1988), 88 D.T.C. 6101 (F.C.T.D.) [*Burns*] at 6103-04, aff'd (1990), 90 D.T.C. 6335 (F.C.A.); *Friedberg*, *supra* note 118 at 6032; and *Whent v. The Queen* (1996), 96 D.T.C. 1594 (T.C.C.) at 1791, aff'd (2000), 2000 D.T.C. 6001 (F.C.A.).

¹²⁰ Art. 1806 C.C.Q. See also Art. 1810: “[a] remunerative gift or a gift with a charge constitutes a gift only for the value in excess of that of the remuneration or charge.”

¹²¹ R.S.C. 1985, c. I-21, s. 8.1.

¹²² For a more detailed discussion of these issues, see David G. Duff, “The Federal Income Tax Act and Private Law in Canada: Complementarity, Dissociation, and Canadian Bijuralism” (2003) 51 Can. Tax J. 1. See also Blake Bromley, “Flaunting and Flouting the Law of Gift: Canada Customs and Revenue Agency's Philanthrophobia” (2002) 21 E.T.P.J. 177.

¹²³ *Francoeur v. The Queen*, [1993] 2 C.T.C. 2440 (T.C.C.).

¹²⁴ According to the CCRA: “Generally, any legal obligation on the payor to make a donation would cause the donation to lose its status as a gift. However, when a taxpayer honours a personal guarantee concerning a loan made to a charity or honours a pledge, the amount can be considered to be a gift despite its being paid to honour an obligation, if the obligation was entered into voluntarily and without consideration.” CCRA, Interpretation Bulletin IT-110R3, “Gifts and Official Donation Receipts” (20 June 1997) at 3-4 [CCRA, “Gifts and Official Donation Receipts”].

price substantially in excess of their value,¹²⁵ other cases have generally disallowed deductions or credits for charitable contributions where the donor has received valuable consideration in exchange for the contribution¹²⁶—even where the taxpayer has sold property to a charitable organization for less than its fair market value¹²⁷ or purchased property from a charitable foundation for an amount exceeding its fair market value.¹²⁸ Where the donor derives a tax advantage or other monetary benefit from the contribution, however, courts have generally held that these benefits do not vitiate the existence of a gift.¹²⁹ As an administrative practice, moreover, the CCRA allows donors to claim as a qualifying gift “the difference between the purchase price of a ticket to attend a ‘dinner, ball, concert or show’ and the fair market value of the food, entertainment, etc., available to a ticket purchaser,”¹³⁰ as well as “a part of a parent’s payment for instruction at a private elementary or secondary school which

¹²⁵ *Aspinall v. M.N.R.* (1970), 70 D.T.C. 1669 (Tax Appeal Board). For a similar result, see *Gagnon Estate v. M.N.R.* (1960), 60 D.T.C. 347, in which the difference between the fair market value of a farm sold by the taxpayer to her sons and the actually proceeds received was characterized as a gift for the purpose of the gift tax in then s. 111 of the *Act* at 348. In two other cases, however, Quebec courts have adopted the common law concept of a gift for the purpose of other provisions in the *Act*. See *The Queen v. Littler* (1978), 78 D.T.C. 6179 (F.C.A.) (refusing to apply gift tax to the sale of shares to the taxpayer’s son for an amount less than their fair market value on the basis that the civil law concept of a gift “should not be taken to extend the application of section 111 of the *Income Tax Act* in the Province of Quebec beyond what it would be in another province” at 6182); and *Gervais v. The Queen* (1984), 85 D.T.C. 5004 (F.C.T.D.) (concluding that property acquired by the taxpayer from his father at a cost less than its fair market value was not acquired by way of a gift).

¹²⁶ See e.g. *Woolner, McBurney, and Zandstra*, *supra* note 119 (each of which involved gifts to religious schools attended by one or more of the donor’s children); *Burns*, *supra* note 119 (gifts to a ski association which conducted a ski camp attended by the donor’s daughter); *Dupriez v. The Queen* (1998), 98 D.T.C. 1790 (T.C.C.) (gifts to a charitable organization which assisted donors in adopting children from Vietnam); and *Nadeau v. Canada* (2001), 2003 D.T.C. 18 (T.C.C.) (donation to college in exchange for which taxpayer received a computer). For a contrasting result, see *Jubenville v. The Queen*, [2002] 4 C.T.C. 2058 (T.C.C.), in which the court disallowed \$3,000 of a \$14,000 contribution to a Russian organization on the basis that it was required to adopt a child, but allowed the taxpayer to claim a charitable contributions tax credit for the remaining \$11,000.

¹²⁷ *Gaudin v. M.N.R.* (1955), 55 D.T.C. 385 (Tax Appeal Board) [*Gaudin*].

¹²⁸ *Tite v. M.N.R.* (1986), 86 D.T.C. 1788 (T.C.C.) [*Tite*].

¹²⁹ See e.g. *Friedberg*, *supra* note 118 (“The tax advantage which is received from gifts is not normally considered a ‘benefit’ within [the legal definition of a gift], for to do so would render the charitable donations deductions unavailable to many donors” at 6032); and *Langlois v. The Queen*, [1999] 3 C.T.C. 2589 (T.C.C.) (“The fact that the donor was able to incidentally derive a monetary benefit from the transactions is of no consequence, since the donee paid no consideration” at 2615), *aff’d* 2000 D.T.C. 6612 (F.C.A.). As a result, although some cases have suggested that a gift requires a “liberal intent” or a “detached and disinterested generosity,” the prevailing view ignores these subjective factors. See *Burns*, *supra* note 119 at 6105; and *Tite*, *ibid.* at 1791.

¹³⁰ CCRA, “Gifts and Official Donation Receipts”, *supra* note 124 at 3.

offers both secular (academic) and religious education" equal to the part "for the religious education only."¹³¹

With respect to the kinds of contributions that can be the subject matter of a gift, an early case suggested that "gifts made in kind instead of cash are not deductible in practice on account of the problem of correct valuation."¹³² Notwithstanding this concern, a subsequent decision confirmed that donors may claim a deduction or credit for gifts of property in kind.¹³³ As an administrative practice, however, the CCRA does not recognize gifts-in-kind of nominal value, such as gifts of used clothing with little commercial value.¹³⁴ In addition, where an individual donates time and labour to a charitable organization or foundation it has been held that the value of the donation is not a qualifying gift for the purposes of the deduction or credit on the basis that the legal meaning of a gift requires the transfer of property and services are not property.¹³⁵

C. Tax Benefit

Where a taxpayer makes a qualifying gift to an eligible recipient, the *Act* provides three different kinds of tax benefits: a deduction for corporations, a credit for individuals, and full or partial exemption from capital gains tax on gifts of cultural property, publicly traded securities, and ecologically sensitive land. This section examines each of these incentives.

1. Deduction for Corporations

Where a corporation makes a qualifying gift to an eligible recipient, the fair market value of the gift is deductible in computing the corporation's taxable income for the year or for any of the five subsequent taxation years.¹³⁶ While there is no limit on the deductions for gifts of

¹³¹ Registered Charities Newsletter No. 6 (1996), online: CCRA <<http://www.ccradrc.gc.ca/E/pub/tg/charitiesnews-06/news6-e.html>>.

¹³² Gaudin, *supra* note 127 at 386.

¹³³ *Consolidated Truck Lines v. MNR* (1968), 68 D.T.C. 399 (Tax Appeal Board) (donation of a yacht to the University of Toronto).

¹³⁴ CCRA, Interpretation Bulletin IT-297R2, "Gifts in Kind to Charity and Others" (21 March 1990) at para. 6.

¹³⁵ *Slobodrian v. The Queen*, [1998] 3 C.T.C. 2654 (T.C.C.); *Slobodrian v. Canada*, [2002] 1 C.T.C. 2089 (T.C.C.); and *Nasrallah c. Canada* (2002), 2003 D.T.C. 1283 (T.C.C.). See also CCRA, "Gifts and Official Donation Receipts", *supra* note 124 ("[a] gift must involve property. Contributions of services (that is, time, skills, effort) are not property and do not qualify" at 5).

¹³⁶ *Act*, *supra* note 2, s. 110.1(1).

cultural property and ecologically sensitive land,¹³⁷ the deduction for other gifts is generally subject to a ceiling of 75 per cent of the donor's income for the year.¹³⁸ Where the corporation makes a gift of property resulting in a taxable capital gain or recaptured depreciation, a quarter of this inclusion may be added to the annual ceiling, effectively increasing the ceiling on these charitable gifts to the amount of the donor's income for the year.¹³⁹

While the current provision was enacted only in 1988,¹⁴⁰ a deduction for corporate charitable contributions dates back to 1930 when the federal government introduced a deduction available to all taxpayers of up to 10 per cent of their incomes for the year.¹⁴¹ Although there does not appear to have been any justification for a corporate deduction at the time,¹⁴² the Exchequer Court speculated on the deduction's purpose in *Olympia Floor & Wall Tile (Que.) Ltd. v. MNR*:

Presumably, a time came in the evolution of income tax law when, the more sophisticated campaigns of charitable organizations having resulted in corporations being forced to make charitable contributions (not because they were as corporations capable of charitable motivation but because an atmosphere was created in which a failure to contribute would damage the corporate "image" so as to affect adversely the corporation's business operations), Parliament, for that reason, decided that corporations should have some sort of tax treatment for such contributions as individuals.¹⁴³

While this account seems to suggest that corporate charitable contributions would be ordinarily deductible in computing the donor's net income from its business operations, the court distinguished the deduction for charitable contributions from the deduction for business expenses on the basis that the former permits "a deduction of an amount that has been given out of the corporation's income after it has been earned and not a deduction of an amount that has been laid out as part of the income earning process."¹⁴⁴ Since the court allowed the taxpayer to deduct gifts to charitable organizations as ordinary business expenses on the basis that

¹³⁷ *Ibid.*, ss. 110.1(1)(c) and (d).

¹³⁸ *Ibid.*, s. 110.1(1)(a).

¹³⁹ *Ibid.*

¹⁴⁰ *Income Tax*, S.C. 1988, c. 55, s. 78.

¹⁴¹ For a brief history of the introduction of this deduction, see Duff, "Charitable Contributions", *supra* note 5 at 408-09. The 10 per cent ceiling on allowable deductions was reduced to 5 per cent in 1940 and increased to 10 per cent in 1957, 20 per cent in 1972, 50 per cent in 1996, and 75 per cent for 1997 and subsequent taxation years (*ibid.* at 421).

¹⁴² See *ibid.*

¹⁴³ *Supra* note 1 at 283.

¹⁴⁴ *Ibid.*

they were incurred for the purpose of gaining or producing income, it follows that the separate deduction for corporate charitable contributions should be understood not as a necessary adjustment to accurately measure income for the year, but as a tax incentive or tax expenditure designed to provide further encouragement to corporate charitable giving irrespective of business considerations.¹⁴⁵

As a tax expenditure, the deduction for corporate charitable contributions is estimated to have cost the federal government \$180 million in 1998.¹⁴⁶ As a general rule, the additional cost to provincial treasuries, which levy identical or similar corporate income taxes at approximately half the federal rates, is roughly half the amount of the federal expenditure. Statistics on the distribution of corporate donations among different kinds of registered charities or the distribution of this expenditure among different corporations are unavailable. Since corporations are generally taxed at a flat rate, one might conclude that the distribution of the tax expenditure among different corporations does not raise any concerns about tax equity. However, since federal and provincial corporate income tax rates vary according to the kind of income earned, with lower rates for "manufacturing and processing" income, and for the first \$300,000 of "active business income" earned by a "Canadian-controlled private corporation," the corporate deduction provides a different level of tax assistance for donations from different corporate entities. More significantly, where the donor corporation incurs a loss, the value of the deduction is nil, since there is no income against which the fair market value of a gift may be deducted.

2. Individual Credit

Unlike charitable contributions by corporations, charitable contributions by individuals are recognized in the form of a tax credit rather

¹⁴⁵ In this respect, the scheme of the *Act* assumes a "social responsibility" view of the corporation, rather than a "profit maximizing" approach. For an illuminating discussion of these issues in the U.S. context, see Nancy J. Knauer, "The Paradox of Corporate Giving: Tax Expenditures, The Nature of the Corporation, and the Social Construction of Charity" (1994) 44 DePaul L. Rev. 1 (advocating repeal of a separate deduction for corporate charitable contributions and the deduction of these gifts as ordinary business expenses at 41-43).

¹⁴⁶ Department of Finance, *Tax Expenditures*, *supra* note 66 at Table 2. This amount includes deductions for "charitable gifts" proper, as well as gifts to the federal government or a province. According to the Department of Finance, the cost of this tax expenditure is projected to increase to \$200 million in 1999 and \$250 million in 2000, after which it is expected to fall to \$215 million in 2001 and \$165 million in 2002, due to decreases in the general corporate tax rate and reductions in projected taxable income.

than a deduction. At the federal level, this credit is computed at the lowest marginal rate of tax for the first \$200 of total gifts claimed in the taxation year and the highest marginal rate for amounts exceeding \$200.¹⁴⁷ For the year 2002, the federal rate structure implied a credit of 16 per cent on the first \$200 claimed each year and 29 per cent on amounts over \$200.¹⁴⁸ Most provinces adopt a similar two-tiered rate structure for their credits, which generally range from 6.05 to 11.25 per cent on the first \$200 and 14.07 to 18.02 per cent on amounts above this threshold.¹⁴⁹ As a general rule, therefore, the combined federal and provincial rates for this credit are approximately 25 per cent up to \$200 and 45 per cent above this amount.¹⁵⁰ Since the credits are non-refundable and non-transferable, however, they are worthless to individual donors whose incomes are too low to pay any tax. This problem is alleviated partly by a CCRA administrative practice allowing an individual to claim charitable donations made by the individual's spouse or common-law partner and dependants, regardless of who actually made the gift.

Like the corporate deduction, the individual credit allows taxpayers to claim the fair market value of gifts that were made during the year or any of the five preceding taxation years.¹⁵¹ Also like the corporate deduction, the aggregate value of gifts that may be claimed in the year is subject to a limit of 75 per cent of the donor's income for the year, except for gifts of cultural property or ecologically sensitive land, or where the gift results in a taxable capital gain or recaptured depreciation.¹⁵² Where an individual dies, the ceiling is increased to the individual's income for that year and the year before death,¹⁵³ and gifts that cannot be claimed in the year of the

¹⁴⁷ *Act, supra* note 2, s. 118.1(3).

¹⁴⁸ See *ibid.*, s. 117(2), as indexed by s. 117.1, which defines basic federal tax payable as 16 per cent of taxable income up to \$31,677; 22 per cent of taxable income between \$31,678 and \$63,354, 26 per cent of taxable income between \$63,355 and \$103,000; and 29 per cent of taxable income exceeding \$103,000.

¹⁴⁹ In Alberta, where a flat-rate income tax of 10 per cent was introduced effective 2001 and subsequent taxation years, the credit is computed at 10 per cent for the first \$200 and 12.75 per cent on amounts over \$200 (*Alberta Personal Income Tax Act*, R.S.A. 2000, c. A-30, s. 11(1)). In Quebec, the credit is computed at a rate of 20 per cent on the first \$2,000 claimed in the year, and 24 per cent on amounts over \$2,000 (*Taxation Act*, R.S.Q. c. I-3, s. 752.0.10.6).

¹⁵⁰ The exceptions are Alberta, where the combined rate on amounts exceeding \$200 is 41.75 per cent, and Quebec, where combined rates are 36 per cent on amounts up to \$200, 49 per cent on amounts between \$200 and \$2,000, and 53 per cent on annual contributions exceeding this amount (*ibid.*).

¹⁵¹ *Act, supra* note 2, s. 118.1(1).

¹⁵² *Ibid.*

¹⁵³ See *ibid.*, s. 118.1(1)(a)(ii) for the definition of "total gifts."

individual's death may be carried back to be claimed in the previous taxation year.¹⁵⁴

The non-refundable credit was introduced in 1988, at which time the federal government repealed a general deduction for charitable contributions that was first enacted in 1930.¹⁵⁵ Critics had argued that providing a larger tax benefit to high-income taxpayers than to low-income taxpayers was a regressive way to encourage charitable donations, because it provided a larger tax subsidy to charities favoured by high-income donors than it did to those preferred by low-income donors.¹⁵⁶ Although acknowledging that equity would favour "a system of tax credits for charitable donations" so that "[t]he tax concession would ... be related only to the size of the donation and would not also depend upon the income of the taxpayer,"¹⁵⁷ the Carter Commission recommended that the deduction "should be continued" on the grounds that a credit would "tend to stifle charitable giving by upper income individuals and families."¹⁵⁸

While the Carter Commission did not explain why a reduction in charitable giving by upper income individuals and families justified an admittedly inequitable deduction, two arguments might be made. First, if the price elasticity of charitable giving increases with income, as some studies have suggested,¹⁵⁹ a deduction for charitable donations would be more efficient than a flat-rate credit, encouraging more charitable gifts than a credit costing the same amount in terms of foregone revenue.¹⁶⁰ Second, if the kinds of charities that high-income donors tend to prefer (hospitals, universities, and cultural institutions) produce greater social benefits than the charities generally favoured by low-income taxpayers (churches and

¹⁵⁴ *Ibid.*, s. 118.1(4).

¹⁵⁵ For a brief history of the introduction of this deduction, see Duff, "Charitable Contributions", *supra* note 5 at 408-09.

¹⁵⁶ See e.g. Thirsk, *supra* note 10 ("[u]nder the present system, the price of charitable donations is significantly cheaper if made by a wealthy donor rather than a poor one. Consequently, the charities favoured by the rich receive greater encouragement than those patronized by the poor" at 37).

¹⁵⁷ *Report of the Royal Commission on Taxation*, *supra* note 33 at 222.

¹⁵⁸ *Ibid.* This argument necessarily assumes that the rate or rates for the credit would be less than the top marginal rate.

¹⁵⁹ See e.g. Henry Aaron, "Federal Encouragement of Private Giving" in *Tax Impacts on Philanthropy*, *supra* note 22 at 210. For a brief explanation of the "price elasticity of giving," see *supra* note 48.

¹⁶⁰ See e.g. Graham Glenday, Anil K. Gupta & Henry Pawlak, "Tax Incentives for Personal Charitable Contributions" (1986) 68 Rev. Econ. & Stat. 688 (estimating that a revenue-neutral tax credit of 29 per cent would cause aggregate donations to fall by \$10 million, while a high-rate credit of 50 per cent would increase aggregate donations by only \$6 million at a cost in terms of foregone revenue of \$422 million at 692).

religious organizations) a deduction would provide a larger indirect subsidy to "more worthy" organizations than a flat-rate credit costing the same amount in foregone revenues.¹⁶¹ In response to these arguments, however, critics of a deduction could point to studies challenging the assumption that the price elasticity of charitable giving increases with income,¹⁶² questioning whether the kinds of charities favoured by high-income donors do in fact provide more public benefits than those preferred by low-income donors,¹⁶³ and contending that any decision to favour donations to some charities over donations to others should be explicit, rather than obscured in the form of a deduction.¹⁶⁴

Weighing the pros and cons of deductions and credits, the federal government opted, as mentioned above, to repeal the deduction for individual charitable contributions effective for 1988 and subsequent taxation years, introducing in its place a credit that would "increase fairness by basing tax assistance on the amount given, regardless of the income level

¹⁶¹ See e.g. Faye L. Woodman, "The Tax Treatment of Charities and Charitable Donations Since the Carter Commission: Past Reforms and Present Problems" (1988) 26 Osgoode Hall L.J. 537 ("Simply, an argument may be made that some institutions are richer contributors to the social, cultural, and intellectual mosaic than others. Hence, it may be possible to justify a system of deduction that is skewed in the direction of the favourite charities of upper-income taxpayers" at 575). For studies suggesting that high-income donors tend to give more to hospitals, universities, and cultural institutions, while low-income donors favour churches and religious organizations, see Taussig, *supra* note 38; Martin Feldstein, "The Income Tax and Charitable Contributions: Part II—The Impact on Religious, Educational and Other Organizations" (1975) 28 Nat'l Tax J. 209; and Kitchen & Dalton, *supra* note 52. For a "somewhat less elitist" version of this argument, see Simon, *supra* note 64 (suggesting that "whether or not wealthy givers are better suited to uphold cultural and intellectual standards, affluent individuals are more likely to be idiosyncratic or unorthodox" and contending that this "idiosyncrasy and heterodoxy" might justify "the egalitarian deduction in the name of pluralism" at 69).

¹⁶² See e.g. Michael J. Boskin & Martin Feldstein, "Effects of the Charitable Deductions on Contributions by Low Income and Middle Income Households: Evidence from the National Survey of Philanthropy" (1978) 59 Rev. Econ. & Stat. 351; and Yong S. Choe & Jinook Jeong, "Charitable Contributions by Low- and Middle-Income Taxpayers: Further Evidence with a New Method" (1993) 46 Nat'l Tax J. 33.

¹⁶³ See e.g. Scharf, Cherniavsky & Hogg, *supra* note 39 ("[a]vailable evidence ... seems to suggest that the activities of the nonprofit organizations and charities typically supported by the rich do not produce higher valued externalities than do those supported by lower income earners. In fact, the converse may be true: universities and cultural organizations are charities that may be viewed as more "local" than churches and religious organizations. Thus larger giving by high income earners should be discouraged on efficiency grounds, while smaller gifts by low income earners should be encouraged" at 28); and Duff, "Charitable Contributions", *supra* note 5 ("[i]n a pluralistic society ... who is to say that the public benefits associated with religious activities are any less than those associated with higher education?" at 435).

¹⁶⁴ See e.g. Wolkoff, *supra* note 51 ("if some institutions are to be favored over others, the decision should be made democratically" at 291); and Brooks, *Financing the Voluntary Sector*, *supra* note 28 ("[i]f certain activities are to be favoured over others, that choice should be clearly reflected on the face of the instrument chosen" at 26).

of the donor.”¹⁶⁵ In order to “maintain a substantial incentive for charitable giving”¹⁶⁶ without significantly increasing the cost of the incentive in terms of foregone revenues, the credit was set at the lowest marginal rate of tax on charitable donations claimed up to \$250, and the highest marginal rate of tax on amounts exceeding this threshold. In 1994, the \$250 threshold was lowered to \$200.¹⁶⁷

Although promoted as a fairer incentive for charitable contributions, which would provide an “equal reward for effort in giving by donors in all income brackets,”¹⁶⁸ empirical analysis suggests that the credit continues to provide a greater tax benefit to high-income donors than low-income donors. As Table 1 illustrates, since average contributions by low-income taxpayers are either less than or not much greater than the \$200 threshold, while average contributions by high-income taxpayers greatly exceed the \$200 threshold, a significant proportion of charitable donations by low-income taxpayers are creditable at the lowest marginal rate, whereas most charitable contributions by high-income taxpayers are creditable at the highest marginal rate. In 1999, for example, the average rate of the credit for charitable contributions was 23.6 per cent for donors with incomes less than \$10,000 compared to 28.8 per cent for donors with incomes exceeding \$250,000. Since the credit is not refundable, moreover, it provides no support for charitable giving by taxpayers whose incomes are too low to pay any tax. As a result, as one commentator has suggested, the two-tier credit is properly regarded as “a deduction masquerading as a credit.”¹⁶⁹

¹⁶⁵ Hon. Michael Wilson, *Tax Reform 1987: White Paper* (Ottawa: Minister of Supply and Services, 1987) at 32.

¹⁶⁶ *Ibid.*

¹⁶⁷ *Act, supra* note 2 as am. by *Income Tax*, S.C. 1995, c. 3, s. 34.

¹⁶⁸ Department of Finance, *Supplementary Information Relating to Tax Reform Measures*, (Ottawa: Department of Finance, 1987) at 10.

¹⁶⁹ Bromley, *supra* note 35 at 9.

Table 1: Average Federal Charitable Tax Credit Rates by Income Class (1999)¹⁷⁰

INCOME CLASS (\$)	AVERAGE DONATION FOR TAXFILERS CLAIMING DONATIONS (\$)	AVERAGE FEDERAL CHARITABLE TAX CREDIT (\$)	AVERAGE FEDERAL CHARITABLE TAX CREDIT RATE (%)
Loss or Nil	0	0	0
1 – 10,000	218	51	23.6
10,000 - 30,000	520	135	26.0
30,000 - 60,000	680	182	26.7
60,000 - 100,000	1,200	327	27.2
100,000 - 250,000	2,300	646	28.3
Over 250,000	14,670	4,232	28.8

Source: *Income Statistics 2001: 1999 Tax Year*, online: CCRA, <<http://www.ccra-adrc.gc.ca/tax/individuals/stats/gb99/pst/interim/pdf/table2-e.pdf>>.

In addition, as Table 2 illustrates, since taxpayers with higher incomes are both more likely to make charitable gifts than low-income taxpayers and able to make larger donations, the credit provides a much larger indirect subsidy to charities favoured by high-income taxpayers than those selected by low-income taxpayers. In 1999, for example, the 21.7 per cent of taxfilers with incomes between \$10,000 and \$30,000 received only 0.5 per cent of the total charitable tax credits claimed, while the 0.4 per cent of taxfilers with incomes exceeding \$250,000 received almost 20 per cent of these credits. As the tax expenditure resulting from the individual charitable donations credit was estimated at \$1.35 billion in 1999,¹⁷¹ these figures suggest that taxpayers reporting incomes over \$250,000 in that year obtained an aggregate tax benefit from the charitable contributions credit of approximately \$260 million.

¹⁷⁰ "Average Donation for Taxfilers Claiming Donations" calculated as the aggregate of charitable donations, government gifts, cultural gifts, and ecological gifts reported by taxfilers in the income category, divided by the number of taxfilers in the income category claiming the charitable donations credit. "Average Federal Charitable Tax Credit" calculated as the aggregate value of tax credits received by taxfilers in the income category, divided by the number of taxfilers in the income category claiming the charitable donations credit. "Average Federal Charitable Tax Credit Rate" calculated as the aggregate value of tax credits received by taxfilers in the income category, divided by the aggregate value charitable donations, government gifts, cultural gifts, and ecological gifts reported by taxfilers in the income category.

¹⁷¹ Department of Finance, *Tax Expenditures*, *supra* note 66 at Table 1. This figure is projected to remain the same in 2000, to decrease to \$1.335 billion in the year 2001, and to increase thereafter to \$1.36 billion in 2002, \$1.385 billion in 2003, and \$1.41 billion in 2003.

Table 2: Distribution by Income Class of Taxfilers, Charitable Donations Claimed, and Tax Credits (1999)

INCOME CLASS (\$)	PERCENTAGE OF TAXFILERS	PERCENTAGE OF TAXFILERS IN CLASS CLAIMING CHARITABLE CONTRIBUTIONS	PERCENTAGE OF AGGREGATE CHARITABLE TAX CREDITS CLAIMED
Loss or Nil	3.8	0	0
1 – 10,000	21.7	2.6	0.5
10,000 – 30,000	39.6	20.9	18.1
30,000 – 60,000	25.8	39.7	30.1
60,000 – 100,000	6.7	51.1	18.1
100,000 – 250,000	1.9	68.4	13.6
Over 250,000	0.4	74.3	19.6

Source: *Income Statistics 2001: 1999 Tax Year*, online: CCRA, <<http://www.ccr-a-adrc.gc.ca/tax/individuals/stats/gb99/pst/interim/pdf/table2-e.pdf>>.

3. Capital Gains Exemptions for Gifts of Appreciated Property

Where an individual or corporation makes a gift of property that has appreciated in value, the taxpayer is deemed to have disposed of the property for proceeds equal to its fair market value, thereby triggering tax on the accrued gain.¹⁷² Where the property is capital property, held for investment purposes or personal use, only half the gain is included in computing the taxpayer's income,¹⁷³ reducing the effective tax rate on these gains to half the rate otherwise applicable. Where the capital property is qualifying cultural property, however, the *Act* exempts any capital gain on the disposition of the property to a designated institution or public authority, irrespective of whether the property is disposed of by way of a gift or a sale.¹⁷⁴ Where the capital property is a publicly traded security that is donated to a qualified donee other than a private foundation, or ecologically sensitive land that is donated to the federal government or a province or to a registered charity other than a private foundation "one of the main purposes of which is ... the conservation and protection of

¹⁷² See *Act*, *supra* note 2, s. 69(1)(b), which applies to gifts *inter vivos*, and s. 70(5), which applies to capital property transferred at death.

¹⁷³ *Ibid.*, s. 38(a).

¹⁷⁴ *Ibid.*, s. 39(1)(a)(i.1).

Canada's heritage," the *Act* reduces the percentage of the gain included in computing the taxpayer's income from one-half to one-quarter.¹⁷⁵

The incentive for gifts or sales of cultural property was enacted in 1977,¹⁷⁶ and is designed to facilitate the preservation of these cultural properties in Canada by encouraging their transfer to institutions or public authorities designated under the *Cultural Property Export and Import Act*.¹⁷⁷ According to subsection 11(1) of this statute, qualifying cultural property includes: (1) objects "of outstanding significance" by reason of their "close association with Canadian history or national life," their "aesthetic qualities," or their "value in the study of the arts or sciences"; and (2) objects "of such a degree of national importance" that their "loss to Canada would significantly diminish the national heritage." The determination that a property is qualifying cultural property is made by the Canadian Cultural Property Export Review Board, established under the authority of the same statute.¹⁷⁸ The tax expenditure resulting from this incentive was estimated at \$11 million in 1998 and \$16 million in 1999.¹⁷⁹

The incentive for gifts of ecologically sensitive land was introduced in 2000¹⁸⁰ and is designed to further "[t]he protection of Canada's natural heritage, and especially its species at risk" by "providing assistance to encourage Canadians to take voluntary action to protect species and to make responsible stewardship an easy choice."¹⁸¹ Like the exemption for transfers of cultural property, this incentive reflects a policy decision that gifts of this kind are of sufficient national importance that they merit a larger measure of tax assistance. Because the provision was introduced only recently, estimates of the resulting tax expenditure are not currently available.¹⁸²

¹⁷⁵ *Ibid.*, ss. 38(a.1) and (a.2).

¹⁷⁶ *Cultural Property Export and Import Act*, S.C. 1974-75-76, c. 50, s. 48, proclaimed in force on September 6, 1977.

¹⁷⁷ *Supra* note 4, s. 32(2).

¹⁷⁸ *Ibid.*, s. 11.

¹⁷⁹ Department of Finance, *Tax Expenditures*, *supra* note 66 at Table 1. The estimated cost of this provision was projected to drop to \$14 million for 2000 and \$10 million thereafter.

¹⁸⁰ *Act*, *supra* note 2 as am. by S.C. 2001, c. 17, s. 22(3).

¹⁸¹ Department of Finance, *Tax Measures: Supplementary Information* (Ottawa: Department of Finance, 2000) [Department of Finance, *Tax Measures*].

¹⁸² In its most recent tax expenditure analysis, however, the Department of Finance includes the cost of this measure together with its estimate for the cost of the reduced inclusion rate for donations of publicly traded shares. For 2001 and subsequent taxation years, the combined cost of these tax expenditures is estimated at \$12 million (Department of Finance, *Tax Expenditures*, *supra* note 66 at Table 1).

The incentive for gifts of publicly traded securities was introduced in 1997 and originally applied only to gifts made after February 18, 1997 and before 2002.¹⁸³ According to supplementary information released with the 1997 Federal Budget, this provision was enacted in order to “facilitate the transfer of appreciated capital property to charities to help them respond to the needs of Canadians.”¹⁸⁴ In a special release issued on October 12, 2001, the Minister of Finance announced that the incentive was “an effective additional incentive for people to make donations to charities,” and would be made permanent.¹⁸⁵ While the incentives for cultural property and ecologically sensitive land are intended to provide a larger tax subsidy for gifts producing a greater public benefit, the incentive for gifts of publicly traded securities is merely intended to increase aggregate donations irrespective of the charitable activities that these donations support. Assuming that donations of capital property are more responsive to the after-tax cost of charitable giving than contributions out of annual income,¹⁸⁶ this measure might be expected to increase aggregate charitable donations at less cost in terms of foregone revenue than other tax incentives such as an increase in the rate of the credit. Although it is difficult to determine whether this incentive has increased aggregate donations, or merely induced donors to substitute gifts of publicly traded securities for other gifts, data assembled by the federal Department of Finance indicate that the number of donors claiming this partial exemption increased from roughly 500 in 1997 to 2,400 in 2000, and that aggregate gifts of publicly traded securities increased from \$69.1 million in 1997 to \$200.3 million in 2000.¹⁸⁷ The tax expenditure resulting from this incentive was estimated at \$6 million in 1997 and 1998 and \$13 million in 1999 and

¹⁸³ *Act, supra* note 2 as am. by S.C. 1998, c. 19, s. 6. For more detailed analyses of this provision, see “Policy Forum: Comments on the Department of Finance’s ‘Special Federal Tax Assistance for Charitable Donations of Publicly Traded Securities’” (2003) 51 *Can. Tax J.* 902.

¹⁸⁴ Department of Finance, *Tax Measures, supra* note 181.

¹⁸⁵ Canada, Department of Finance, News Release, “Special Federal Tax Assistance for Charitable Donations of Publicly Traded Securities Made Permanent” (12 October 2001) [Department of Finance News Release].

¹⁸⁶ See Duff, “Charitable Contributions”, *supra* note 5 (noting that “empirical studies do not appear to have confirmed the result” at 432).

¹⁸⁷ Department of Finance, *Tax Expenditures, supra* note 66 at 64. According to this study, donations of publicly traded securities were disproportionately made to large charities and to educational institutions. The latter conclusion is consistent with empirical studies indicating that affluent donors are more likely to make charitable gifts to educational institutions.

projected to increase to \$15 million in 2000, decreasing thereafter to \$12 million from 2001 to 2004.¹⁸⁸

However effective these additional tax incentives may be as methods of either encouraging charitable donations or subsidizing gifts with substantial public benefits, there are two reasons to question the design of these incentives as full or partial exemptions from capital gains tax otherwise payable on gifts of appreciated property. First, as William Andrews has observed, the additional "subsidy or artificial inducement" to charitable giving from this approach is both arbitrary and inequitable, since "[t]he magnitude of the subsidy is a function of the amount of unrealized appreciation in relation to the basis of the property and the taxpayer's rates of tax, being the greatest for taxpayers in highest brackets and with the most appreciation."¹⁸⁹

Second, as Richard Goode explains, this approach "tempts some donors to place excessive values on their gifts, occasionally with the collusion of recipient institutions."¹⁹⁰ Although the incentive for publicly traded securities appears to avoid this objection, since the fair market value of these securities is readily determinable, the incentive for gifts of cultural property was notoriously susceptible to this abuse until the enactment of subsection 118.1(10) of the *Act* in 1990 authorizing the Canadian Cultural Property Export Review Board to determine the fair market value of gifts of cultural property.¹⁹¹ In order to prevent this kind of abuse with gifts of ecologically sensitive land, the *Act* requires the Minister of the Environment to determine the fair market value of these gifts.¹⁹²

Finally, the fact that the main beneficiaries of the incentive for publicly traded securities are almost certain to be among the most affluent donors raises a concern about the effect on philanthropic pluralism. Although the Department of Finance does not appear to have collected data on the distribution of this tax incentive by income group,¹⁹³ data on the distribution by income class of charitable donations claimed in 1996 and

¹⁸⁸ *Ibid.* at Table 1. For 2000 and subsequent taxation years, estimates include both the tax expenditure for gifts of publicly traded securities and the incentive for donations of ecologically sensitive land. See Department of Finance News Release, *supra* note 185. These estimates reflect only the cost of the lower inclusion rate, not the further cost associated with the charitable contributions credit itself. See *ibid.* at 68 (Table 7) for estimates of the associated cost of the charitable contributions credit.

¹⁸⁹ *Supra* note 14 at 372. For a similar critique see Rabin, *supra* note 23 at 926.

¹⁹⁰ *Supra* note 10 at 167.

¹⁹¹ See discussion in *supra* note 118.

¹⁹² *Act*, *supra* note 2, s. 118.1(12).

¹⁹³ Interview of Bill Murphy, Personal Income Tax Division, Department of Finance (17 October 2001) by telephone.

2000 are suggestive. As Table 3 illustrates, while the percentage of aggregate charitable contributions claimed by donors with incomes exceeding \$250,000 was 11.4 per cent in 1996, before the incentive was introduced, this proportion increased to 21.0 per cent in 2000, the year before the incentive was made permanent. In addition, since the value of the incentive increases with the donor's income, the effect of the incentive is to provide a larger indirect subsidy to the kinds of charities favoured by high-income donors. Indeed, educational institutions appear to have been major beneficiaries of this incentive.¹⁹⁴

Table 3: Distribution of Taxfilers and Charitable Donations Claimed by Income Class (1996, 2000)

INCOME CLASS (\$)	PERCENTAGE OF TAXFILERS (1996)	PERCENTAGE OF CHARITABLE DONATIONS CLAIMED (1996)	PERCENTAGE OF TAXFILERS (2000)	PERCENTAGE OF CHARITABLE DONATIONS CLAIMED (2000)
Loss and Nil	4.2	0	3.6	0
1 – 10,000	23.1	0.8	20.7	0.4
10,000 – 30,000	40.9	23.7	38.8	18.2
30,000 – 60,000	24.5	35.6	26.0	29.6
60,000 – 100,000	5.7	17.3	8.2	17.6
100,000 – 250,000	1.4	11.1	2.2	13.5
over 250,000	0.3	11.4	0.5	21.0

Source: CCRA, *Taxation Statistics on Individuals: 1996 Tax Year*, (Ottawa: Minister of Supply and Services, 1998); and *Income Statistics 2002: 2000 Tax Year*, online: CCRA, <<http://www.ccra-adrc.gc.ca/tax/individuals/stats/gb00/pst/interim/pdf/table2-e.pdf>>.

IV. REFORM: RESTRUCTURING TAX INCENTIVES FOR CHARITABLE CONTRIBUTIONS

Specific recommendations for reforms to the current statutory scheme governing the tax treatment of charitable contributions in Canada can be divided into three categories: the kinds of recipients' donations that should qualify for a tax incentive, the kinds of contributions for which the incentive should be available, and the structure of the tax benefit provided to indirectly subsidize eligible recipients by encouraging qualifying

¹⁹⁴ See Department of Finance, *Tax Expenditures*, *supra* note 66 at 64.

contributions. This Part outlines the main conclusions arising from the above analysis.

A. *Eligible Recipients*

Judicial decisions demonstrate the Canadian courts' unwillingness to expand the scope of recognized charitable purposes and activities beyond the traditional categories acknowledged by the common law of charitable trusts. While the fourth *Pemsel* category of "other purposes beneficial to the community" might have permitted such an expansion, the incremental approach taken by the Supreme Court of Canada in *Vancouver Society* appears to have foreclosed this possibility. To the extent that a tax incentive for charitable contributions is intended to provide an indirect subsidy to charitable organizations providing goods and services of public benefit, this outcome is unfortunate. For this and other reasons, including the administrative uncertainty involved in determining charitable status under the common-law definition, it would be desirable to adopt a statutory definition of charitable purposes and activities.

While such a definition might build upon the *Pemsel* categories or the list of charitable activities mentioned in the *Statute of Elizabeth*, it should expand upon these sources in two significant ways. First, since the provision of public benefits is the best rationale for the tax incentive, the statutory definition should make the concept of a public benefit the touchstone for eligibility. Second, to the extent that social and cultural pluralism is itself regarded as a public benefit, the statutory concept should reject the political purposes doctrine and the common law concept of religion, and recognize a public benefit in the advancement of alternative belief systems, both spiritual and ideological, provided that these do not contradict the values of a free and democratic society.

B. *Qualifying Contributions*

Since the purpose of the tax incentive is to provide an indirect subsidy to charitable organizations providing goods and services of public benefit, contributions to eligible recipients should qualify for tax assistance whenever they confer an economic benefit on the recipient regardless of the motivations of the donor. From this perspective, the key criterion is neither the voluntariness of the transfer nor the existence of any consideration in return, but the difference between the value of the contribution and the value of any consideration received in return. While the civil law meaning of a gift is compatible with this approach, the common law concept is needlessly restrictive.

For this reason, and because the *Act* should ensure uniform treatment for charitable contributions in all Canadian provinces, it would be desirable to adopt a statutory definition of a "qualifying contribution" based on the economic substance of a transaction to confer an economic benefit on the recipient, rather than the legal form of the contribution as a "gift" under civil or common law. In addition, since the incentive is intended to subsidize the provision of public benefits by charitable organizations, the concept of a qualifying contribution should apply to contributions of services as well as property.

C. *Tax Benefit*

A tax incentive for charitable contributions is a pluralistic way of subsidizing charitable organizations, enabling donors to direct public subsidies to activities of their choosing by "voting" with their contributions. From this perspective it would be inequitable to weigh these votes differently according to any characteristic personal to the donor, such as the donor's level of income, and inappropriate in most circumstances to bias this choice by providing larger incentives for contributions to some activities than others. Where a policy decision is made to favour some activities over others, however, this differentiation should be transparent and equally available to all potential donors. To the extent that the incentive is intended to promote social and cultural pluralism it should limit the extent to which any one donor can direct public funds and place a greater emphasis on the number of donors than the size of their donations.

From this perspective, there are several flaws with the structure of the tax benefits for charitable contributions provided by the *Act*. First, although the value of the individual tax credit does not explicitly vary with the donor's income, the two-tier structure functions much like a deduction, providing a larger amount of tax assistance to charitable contributions by high-income donors who are able to make larger donations than it does to low-income donors who cannot afford to contribute as much, and providing no assistance to donors whose incomes are too low to pay any tax. The additional incentives for gifts of cultural property, publicly traded securities, and ecologically sensitive land are even more inequitable, since the amount of the tax benefit depends not only on the donor's income but also on whether the donor happens to hold qualifying property that has appreciated in value. Nor is the deduction for corporate donations any better, since the amount of the tax benefit varies according to the kind and amount of income earned. For each of these incentives, therefore, the current rules weigh donors' votes differently, favouring contributions by high-income individuals, and larger and more profitable corporations. The current rules

also fail to moderate inequalities in the number of votes that donors can exercise in order to direct public funds, since annual limits on allowable contributions have risen over the years to 75 per cent or more of the donor's income, and contributions that are made for the purpose of producing income are fully deductible without any limit.

Instead, equity and pluralism would be better served first, by disallowing deductions for charitable contributions made for the purpose of earning income and repealing the deduction for corporate donations; second, by making the individual tax credit a refundable credit with declining rates based on the amount claimed in the year; and third, by replacing the special incentives for gifts of cultural property and ecologically sensitive land with a higher-rate refundable credit for these kinds of gifts, and repealing the partial exemption for gifts of publicly traded securities.

V. CONCLUSION

Although a tax deduction for charitable contributions may be justified where donations are made for the purpose of gaining or producing income, this article has argued that additional tax recognition for charitable contributions is warranted only as a method of indirectly subsidizing the quasi-public goods and services that are provided by charitable organizations and promoting the social and cultural pluralism that these organizations advance. From this perspective, Canada's current tax rules are deficient in several respects and should be reformed along the lines suggested in Part IV.

